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See also testimony of Messrs Mills, Robertson, Mitchell

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Statement of

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Chairman, Board of Governors of the Federal Reserve System

before the

Subcommittee on Bank Supervision and Insurance

of the

House Committee on Banking and Currency

on H.R. 5874

May 8, 1963

Mr. Chairman:

I want to make clear at the outset that in this instance I am appearing in my individual capacity as Chairman and one member of the Board of Governors of the Federal Reserve System, rather than as a spokesman for the Board as a whole. The Board's views on H. R. 729 have already been provided to you in writing, and my statement today will relate only to H. R. 5874, which would establish a Federal Banking Commission to administer all Federal laws relating to the examination and supervision of banks.

I am glad that you will hear from other members of the Board today, so you will have an opportunity to observe for yourself the points at which our views coincide and diverge.

Let me say that I feel that this procedure is especially appropriate in this case. As I will develop later in my statement, I believe that we are confronted with a real problem in the field of bank supervision in the United States. I do not agree with those who feel that it will either disappear with the passage of time or solve itself without legislative action. On the other hand, I do not feel that it is an urgent problem.

Here in Washington to say something is "not urgent" is often taken to mean that we can forget about it, and I hasten to add that I am not using the words in that sense. This is a matter which must be dealt with, but one which, fortunately, I think we can afford to handle carefully and judiciously, rather than in haste. Full discussion of the pros and cons of various approaches to the problem in appropriate public forums is one of the things that is necessary if we are to obtain the best judgments of the many groups that would be affected directly and indirectly by a change in the bank supervisory structure.

We are all indebted to the Commission on Money and Credit for stimulating such discussion by its Report two years ago. Since then, understanding of the problem and one possible approach to its solution has been furthered on several occasions by addresses by my colleague, Governor Robertson. More recently the Advisory Committee on Banking to the Comptroller of the Currency has contributed to the discussion, as has Mr. Cocke, the Chairman of the FDIC. Finally, we have within the past few weeks some further examination into the question by the Presidents' Committee on Financial Institutions, on which I was privileged to serve. All this has been useful, but it is only through the introduction of a bill like H. R. 5874, and hearings like these, that we will get the crystallization of views that is essential to constructive legislation.

Before turning to my own views on the proposed legislation, it may be helpful if I review briefly the history of the present arrangements and various alternatives that have been suggested.

The fact that this is its centenary year makes us especially alert to the fact that the present structure began as far back as 1863, when Congress passed the statute that became known as the National Bank Act. This Act provided for the chartering and supervision of national banks by the Office of the Comptroller of the Currency, a bureau of the Treasury Department. As the name of the office implies, a principal reason for the legislation was to provide a new form of currency--

national bank notes that national banks issued against the pledge of U. S. Government securities. Although now discontinued, national bank notes for many years were this country's principal form of currency.

When the National Bank Act was passed there were many thousands of State banks in the United States. However, there was no Federal supervision of State banks until a half century later, when Congress passed the Federal Reserve Act. One of the purposes stated in the preamble to the Federal Reserve Act was "...to establish a more effective supervision of banking in the United States...". All national banks are required to be members of the Federal Reserve System created by the Act, and any State bank can voluntarily become a member of the System by accepting the requirements of the Act and becoming subject to supervision by the Federal Reserve.

A third group of banks was brought under Federal supervision by the Banking Act of 1933, which established the Federal Deposit Insurance Corporation and provided for the insurance of bank deposits. All member banks of the Federal Reserve System, both national and State, were required to have their deposits insured by the FDIC, and, in addition, any other State bank can obtain deposit insurance by voluntarily accepting the requirements of the deposit insurance legislation and becoming subject to supervision by the FDIC.

Thus the two-way division of Federal bank supervision that had existed since 1913, became a three-way division in 1933, the Comptroller of the Currency having principal responsibility for supervision of national banks, the Federal Reserve for State member banks, and the FDIC for insured State nonmember banks.

In two instances since 1933, Congress has placed responsibility for regulation of all banks in a single Federal agency. The Securities Exchange Act of 1934 placed upon the Federal Reserve Board unified responsibility for regulations regarding stock market credit, not only the margin requirements applicable to brokers and dealers, but also the similar regulations that apply to all banks, even noninsured banks. The Bank Holding Company Act of 1956 established unified supervision of bank holding companies; it requires the Federal Reserve Board to pass on applications of such a holding company to acquire the stock of _any_ bank, even a noninsured bank. In general, however, the three-way division of Federal bank supervision established in 1933 has continued. For example, the bank merger legislation of 1960 divided responsibility for bank mergers among the three supervisory agencies, depending on whether the continuing bank would be a national bank, State member bank, or an insured State nonmember bank. The Act provides that the agency that must pass on a proposed merger must obtain from the other two agencies and also from the Attorney General a report on the competitive factors involved. In 1962, following a recommendation the Federal Reserve Board had made in 1957 and renewed in 1962, Congress transferred authority over trust powers of national banks from the Federal Reserve to the Comptroller of the Currency.

As of the end of 1962, about 98 percent of all the commercial banks of the country were subject to one or another of the three types of Federal bank supervision, and the banks so subject had about 99 percent of the deposits of all commercial banks. Roughly, 34 percent of the banks in the United States with 54 percent of the deposits are chartered as national banks, supervised by the Comptroller of the Currency, and as indicated are also members of the Federal Reserve System. An additional 11 percent of the banks, holding 29 percent of the deposits, are chartered by the States in which they are located but maintain voluntary membership in the System. Finally, 53 percent of the banks, holding 16 percent of the deposits, are insured nonmembers.

To speak of a three-way division of Federal bank supervision, as I have been doing, really is something of a simplification of the actual situation. Banks under the principal supervision of one agency are also subject to regulation by one or more of the others. For example, both national and State member banks are subject to regulations of the Board on several subjects, both national and State members are subject to regulations of the Comptroller of the Currency on the purchase of investment securities, and all three types of banks pay insurance assessments to the FDIC.

The banks principally supervised by the three different agencies are frequently in direct competition with each other for the same kinds of banking business. They are often located in the same communities, even side by side or across the street from each other. Accordingly, different rules applied by the different agencies can profoundly affect competitive relations between different banks.

Over the years there has been a considerable amount of cooperation among the agencies and with the State supervisors, with a view to developing and maintaining desirable and uniform standards of bank supervision. An outstanding example is the agreement on bank examination and reporting procedure that was worked out by the three agencies and the Executive Committee of the National Association of Supervisors of State Banks in 1938, and revised in 1949.

The present three-way division of Federal bank supervision has been strongly supported and also strongly criticized. Those favoring the present structure offer essentially two arguments. They say (1) that it prevents an undue concentration of powers, and (2) that it works reasonably well. Those opposing the present structure disagree with both those arguments. As to the first, they point out that such divided supervisory responsibility is most unusual, in fact is virtually unique to the field of banking; and they insist that there is no such difference between this industry and others as to justify such a widely different supervisory structure. As to the second, they assert that the divided responsibility leads to inefficiency, conflicting policies, and lowered standards; that necessary consistency in policies can be achieved, if at all, only by the expenditure of inordinate amounts of time and effort.

Without attempting here to appraise the arguments pro or con, I can say from personal experience that the present structure does require that considerable time be devoted to liaison, coordination, cooperation and negotiation between the various parts into which the structure is divided.

There have been various proposals for changing the present organizational setup. Some of the more recent plans illustrate the range of possibilities.

The Commission on Money and Credit recommended that responsibility for all Federal supervision over commercial banks be transferred to the Federal Reserve, thus unifying responsibility. Some have argued that this might overburden the System and interfere with its responsibilities for monetary policy. However, others assert that unification of the structure would release much valuable Board time now devoted to efforts at coordination; and that further economies could be achieved, if necessary, by statutory provisions, like those applicable to other agencies, authorizing the Board to delegate some of its duties, thus enabling it to establish general policies without becoming weighted down with the details of implementation.

The present Bill, H. R. 5874 is similar to the proposal by Governor Robertson, which I mentioned earlier. It would transfer all Federal bank supervisory responsibilities to a new five-man Federal Banking Commission. It would unify bank supervision and would relieve the Federal Reserve of all responsibility for this function.

Some assert that elimination of the Federal Reserve from bank supervision would hinder rather than help the formulation and execution of monetary policy. The Federal Reserve is vitally concerned with the soundness, flexibility and competitive structure of commercial banking, since these banking characteristics can greatly affect the transmission of monetary policy actions to the general economy. Similarly, the intimate knowledge of banking conditions that comes from examination and supervision is extremely helpful in the difficult and fluid task of adjusting monetary policies to constantly changing conditions. Monetary policy cannot be effectively conducted in isolation. The present bill attempts to deal with the problem by continuing the present authority of the Board to require reports from national and State member banks of the Federal Reserve System and by providing that the new Federal Banking Commission "may furnish" reports of examination to the Federal Reserve. There is some question whether such provisions are an adequate substitute for the intimate and often nonstatistical knowledge of banks, bankers, and banking conditions that is presently obtained through the exercise of supervisory responsibilities.

Chairman Cocke of the FDIC has suggested another approach to changes in the present supervisory organization. He has suggested that the Federal Reserve be relieved of responsibility for bank supervision and that the FDIC should examine all insured banks, alternating examinations of national banks with the Comptroller of the Currency and of State banks with the State authorities. The proposal apparently contemplates that the Federal Reserve would continue to receive reports and that it would have a small staff of qualified people to review these reports and on occasion to examine commercial banks.

The Advisory Committee on Banking appointed by the Comptroller of the Currency recommended that the Federal Reserve be divested of all supervisory responsibilities and that all supervisory, examination, and regulatory authority relating to national banks be transferred to the Comptroller of the Currency. Under this proposal all such authority over State chartered banks would be transferred to the FDIC, but authority to approve branches of State banks would be relinquished to the State supervisory authorities. The FDIC would be reorganized under a single administrator and transferred to the Treasury Department. The report of the Advisory Committee does not discuss the question of how the Federal Reserve would obtain adequate banking information to enable it to discharge effectively its monetary responsibilities.

From this brief outline of the present organizational structure of Federal bank supervision, of how it developed, and of various proposals for changes, it can be seen that the subject is complex and that it involves a variety of different considerations. The present setup, and also various proposals for changes, each have both advantages and disadvantages.

As is perhaps already apparent, I would not favor action on H. R. 5874, without exploring further the other alternatives. It may be that after we have carefully considered the other proposals that have already been made, and additional alternatives that may be forthcoming, we will return to an approach along the lines of this bill. I would certainly not want to rule out that possibility. But I am not yet persuaded that this bill provides the best solution that can be devised.

In my position as Chairman of the Board of Governors I have had an unusual opportunity to discuss the substance of H. R. 5874, and other proposals for reorganization of bank supervision informally with members of the Congress, Government officials, bankers, businessmen, college professors, and other citizens who cannot be readily classified in any of these groups. I am convinced that many of those who have the broadest knowledge and experience in this field have not resolved in their own minds the best way to proceed, if we are to foster the kind of development of our banking system that will make the greatest contribution to strength and growth of the American economy.

The present arrangements are cumbersome and unwieldy, but they can, I think, be made to work better, even within the scope of the present law, as was pointed out in the recent Report of the Committee on Financial Institutions to the President. We should all do everything in our power to make them do so. Simultaneously, we should move ahead deliberately to examine the advantages and disadvantages of various possibilities and develop a plan that will provide for sound and constructive administration of Federal law in the field of bank supervision in the years ahead.

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