Statements on Bill to Establish A Federal Banking Commission

Statement of William McChesney Martin, Jr., 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.

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 2 years ago. Since then, understanding of the problem and one possible approach to its solution have been furthered on several occasions by addresses by my colleague, Governor Robertson. More recently the Advsory Committee on Banking to the Comptroller of the Currency has contributed to the discussion, as has Mr. Cocke, the Chairman of the Federal Deposit Insurance Corporation. Finally, we have had 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 ar-

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rangements 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 banking 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 became 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 recommenda-

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tion 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 per cent 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 per cent of the deposits of all commercial banks. Roughly, 34 per cent of the banks in the United States with 54 per cent 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 per cent of the banks, holding 29 per cent of the deposits, are chartered by the States in which they are located but maintain voluntary membership in the System. Finally, 53 per cent of the banks, holding 16 per cent 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,

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and negotiation among 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 5-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 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

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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.

Statement of J. L. Robertson, Member of the 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.

I hope no one is misled by the 97 pages of H.R. 5874 into the erroneous notion that this is a complicated bill. By far the greater part comprises necessary transitional provisions and technical changes such as the deletion of complex statutes that this bill would render obsolete, changes in nomenclature, and so on. The significant provisions take up less than 10 pages; in fact, if one reads the statement of policy and pages

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4 through 11, he knows what the bill is about.

What *is* H.R. 5874 about? What would it do? Actually, Mr. Chairman, it is about a situation so obviously and admittedly unsatisfactory, and would provide a solution so obviously sound, reasonable, and effective, that an intelligent visitor from another planet might be puzzled at its being a matter of controversy, to be argued about at length before busy committees of the Congress.

This bill would put an end to the existing hodgepodge in *Federal* supervision of the banking industry. It would do this in a very simple and practical way—by unifying in a single agency, concerned exclusively with the supervision of banking, functions that are now, by unfortunate historical accident, scattered among three authorities: the bureau of the Comptroller of the Currency, the Federal Reserve System, and the Federal Deposit Insurance Corporation.

I have been involved in Federal supervision of banking for over 30 years—ever since the beginning, in 1933, of this Triple Entente (which, regrettably, has not always been an Entente Cordiale). My memory is so crowded with occurrences that demonstrated the defects of the present arrangement that I hardly know where to begin.

Imagine, Mr. Chairman, a city served by 3 television stations—all regulated by the Federal government, as is actually the case. But in my supposititious situation, absurd as it may seem, each station is supervised by a different agency: one by the Federal Communications Commission, one by a Federal Television Board, and one by a Federal TV Authority. Each of these agencies issues its own regulations and interprets the laws as they apply to the stations within its jurisdiction. Consequently, one station is permitted to broadcast commercials at twice normal volume; the second is required to maintain uniform volume at all times; the third must reduce volume by 50 per cent during commercials. One is permitted to use 50,000 watts, even though this interferes with reception of its competitors down the block. One is required to provide "equal time" for political candidates, while its rivals may grant or refuse time as they see fit.

Perhaps air transport would provide a better illustration. Imagine two competing lines on the Philadelphia-Chicago route. One is permitted to provide coach service for $30, including a steak dinner; the other, with similar equipment, is required to charge $32 and is restricted to an American cheese sandwich.

Of course, these imaginary situations are ludicrous. Any such situation would be unthinkable and intolerable, one would say; and yet, Mr. Chairman, this is essentially the way Federal supervision of banking is set up today. The illustrations I could provide from banking are more involved and less dramatic—that is the nature of banking—but that is the only difference.

Suppose, in the imaginery instances I have mentioned, a bill was introduced to correct the obvious difficulties by combining the three agencies into one. And suppose further that the bill was opposed on the ground that perhaps the three might be able to work out an endurable *modus vivendi* by constant consultation, solicitation of each other's views, and study of each other's rules and decisions. I sincerely hope that the congressional committee would ask: "Why should we continue to muddle along with such an awkward, inefficient, expensive arrangement, rather than adopt a simple and obvious solution that is better in every respect?"

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I shall not weary the committee with a long catalogue of the built-in deficiencies of the present structure of Federal bank supervision. A handful of instances should suffice. Some of us can recall, for example, the prolonged controversy over absorption of exchange charges. Bank A may solicit an important account by offering to absorb all such charges for a prospective customer, but its competitor across the street, Bank B, also subject to Federal supervision—but by a different supervisor!—is forbidden to do so. This particular struggle "culminated" 20 years ago in extensive hearings before this committee and its Senate counterpart, but no solution was developed. I should guess that banks and supervisors have seriously tried a half dozen suggested compromises, but the problem is as troublesome today as it was 20 years ago. And this is a situation that would not exist if there were one Federal bank supervisory authority rather than three.

There is hardly a sector of bank supervision of which a similar sad tale could not be told. In the same town, and subject to the same Federal laws and regulations—but different supervisors—one bank may acquire stock of corporations (even the controlling stock of another bank), but its competitor may not; one is denied the privilege of establishing a drive-in branch, but the other may do so on the ground that the facility is not a branch at all; one must apprise the public of its condition 4 times a year, but the other (although subject to the same law regarding the number of reports) only twice a year. Bank A regretfully but truthfully informs a valued customer, such as a hospitalization cooperative, that it is forbidden by its Federal supervisor to extend to it the privileges of an interest-bearing savings account. Bank A thereupon loses the account to Bank B, whose supervisor, interpreting the same law and regulation, rules to the contrary.

In 1960 the Congress passed the Bank Merger Act, which "in the interests of uniform standards" required the three banking agencies to "report" to each other on every proposed merger. Ever since, streams of documents have been flowing between us. Every single merger must be studied by all three agencies. In the past 3 years the members and staffs of the three agencies have spent on this task innumerable hours that were urgently needed for something more constructive than this duplication of effort. The worst of it is that the duplication has been fruitless; nothing resembling "uniform standards" has evolved.

Particular instances like these are easy to pinpoint. However, the most detrimental results of our divided responsibility are not the direct conflicts and inconsistencies, but rather the delay it causes in the performance of our functions and—most fundamental of all—the seemingly insurmountable obstacles to adequate and correct performance. No Federal bank supervisory agency has readily available *all* the basic information that is needed for sound decisions as to bank charters, branch permits, mergers, and all the rest. Much of the essential information must be obtained secondhand from other agencies.

It may reasonably be asked whether the Federal bank supervisory structure can be as indefensible, its operations as clumsy and inequitable, and the solution to all this as simple and obvious, as I maintain. We have had three bank supervisory authorities for almost 30 years. If this arrangement is so irrational and productive of so much friction, waste, and unfairness, why has it been so long endured? The answers to these ques-

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tions not only may be illuminating historically, but may explain and dissipate some of the opposition to H.R. 5874.

Federal bank supervision began just a century ago, with the establishment of the National Banking System. The Federal Reserve Act of 1913 added a second supervisory body, and 20 years later the Federal Deposit Insurance Act created the third. Both of these additions stemmed from economic crises—the Federal Reserve System from the panic of 1907, and the Federal Deposit Insurance Corporation from the great depression. The need for each was urgent and its benefits patent; for this reason "details" of structure and administration were matters of little concern, and perhaps that was warranted. However, after these fundamental improvements were achieved, and the structural deficiencies revealed themselves, no correction was made, notwithstanding the introduction in Congress of several specific bills and some strong calls for action by the Brookings Institution, the Hoover Commission, the Committee for Economic Development's Commission on Money and Credit, and even—at one stage—the Board of Governors of the Federal Reserve System.

How can this inaction be accounted for if a satisfactory solution is so readily available? I should like to answer in the words of the Declaration of Independence: ". . . all experience hath shown, that mankind are more disposed to suffer, while evils are sufferable, than to right themselves by abolishing the forms to which they are accustomed." And I might add, as did Thomas Jefferson, "To prove this, let Facts be submitted to a candid world."

The American banking system—and its supervisors—has "suffered" a long time. It is painful to recall how much effort—unproductive effort—has gone into "consultation, coordination, and cooperation" (to use the standard euphemisms) necessitated by the diffusion of supervisory responsibility. If these efforts had succeeded, we probably would try to make do with the present arrangement, despite its defects, for another decade or two. But as the President's Committee on Financial Institutions pointed out in last month's Report, our "cooperation and coordination" have *not* been successful; the Report notes that exchange of full information and joint efforts recently have broken down. It is no accident that numerous officials, committees, and commissions, in and out of Government, have suggested all manner of expedients during the past 2 years.

May I repeat, Mr. Chairman: The bill before your Committee is designed to do, and would do, just one thing—it would unify Federal supervision of banking. But simply by doing this, it would accomplish much more. It would end much friction and conflict among banks and bank supervisors. It would eliminate wasteful duplication and overlapping among agencies. It would abolish the existing "triple standard" and enable the banking industry to operate under a single, consistent set of rules, as far as Federal supervision is concerned. It would do away with a dangerous tendency toward a "race of laxity" in bank supervision that will lead, at an accelerating rate, to deterioration of the standards of sound banking which it is a function of bank supervision to maintain. And it would enable the Federal Reserve Board, of which I am a member, to devote its time and attention exclusively to its most vital—and increasingly difficult—function: the formulation and execution of monetary policy for the leading industrial nation of the world.

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I do not wish to give the impression that, by escaping from the chamber of horrors in which we find ourselves, we shall automatically emerge into a brave new world when the pending bill is enacted. If one were to say that, of course it would be a misleading oversimplification. H.R. 5874 would *not* solve all questions of banking, its laws and regulations, and its supervision. The bill does not purport to do anything of the sort. It would *not* change the substantive laws and regulations under which the American banking system operates. It would *not*—it *could not*—solve the complex problems of accommodation that are inherent in a dual banking system. It would simply set in order the house of *Federal* bank supervision so that more fundamental problems could thereafter be dealt with in an effective and constructive way.

In view of the foregoing, how are we to account for the absence of universal enthusiasm for this bill? For lukewarm acceptance in some quarters, and downright opposition in others?

In my opinion, it is due principally to lack of complete understanding of the bill and its effects. Everyone has more jobs to do than he can get done—immediate jobs, more exigent than reading and analyzing a document that looks as formidable as H.R. 5874. And unless a proposal is comprehended, there is an understandable fear of the unknown, and an inclination to support the *status quo.* But since last week, when the excellent analysis prepared by the staff of this committee became available, there is no longer any excuse for such lack of understanding and fear of the unknown.

I hope it is realistic, rather than unduly cynical, to say also that it is easier, especially for one who has not read this bill, to take a negative stand. When one supports a measure, he may be asked to explain its provisions, but that burden is seldom imposed on the "disinterested observer" or the opponent. This is particularly true, it seems, if opposition is based on one of the accepted clichés. I should like to mention a few of these, and to comment on them: (1) "The bill would create a Federal superagency in the banking field." (2) "H.R. 5874 would jeopardize the dual banking system." (3) "This proposal would result in a dangerous concentration of power over banking," or, swinging around 180 degrees, (4) "A unified Federal agency would soon become the spokesman for the banking industry rather than its supervisor." And finally, (5) "If there is one thing we don't need it's another Federal commission!"

As applied to H.R. 5874, all of these clichés are superficial and erroneous. Some, I regret to say, seem to be red herrings drawn across the trail by persons who are opposed to improvement in Federal bank supervision for reasons that are *not* in the public interest. Neither this problem nor any other will be solved if we defer to well-worn catch phrases. Charges of the kind I have described must be examined in the light of the *facts,* the *realities,* and when so examined they prove to be without substance.

The pending bill simply does not "create a Federal superagency." The proposed commission would have no new powers over the banking industry, but only those that are now exercised by one or more of the three agencies. This is not quite true; it *would* have one new and important power—the power to administer the Federal banking laws in a consistent, equitable, and efficient manner, to establish uniform ground rules that would aid, rather than impede, the progress of the entire banking industry and equalize competitive opportunities within it.

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What of the charge that H.R. 5874 would jeopardize the dual banking system? Again, it is difficult to say more than "It simply isn't so." If the charge was made that, by holding these hearings, this committee was threatening freedom of the press or of religion, you would find it difficult to formulate a "refutation," other than by asking, "How on earth are we doing that?" Equally groundless is the charge that the pending bill would jeopardize the dual banking system; it sounds less absurd only because we have grown accustomed to hearing that charge leveled at many proposals. On the contrary, enactment of this bill would tend to strengthen the dual banking system. State bank supervisors and their Association would find it possible, for the first time, to solve problems common to State and national banks, member banks of the Federal Reserve System and nonmembers, by working with a single Federal agency. Again and again such problems have failed of solution because Federal authority was divided among three organizations, each with its own views.

Furthermore, H.R. 5874 provides that the costs of supervision of all insured banks —State and national—shall be met out of deposit insurance assessments. In a number of States, because of insufficient funds, bank supervisors have been unable to maintain a staff adequate to carry on the work of their departments and have had to rely on assistance from Federal examiners. The arrangement provided by the pending bill, by relieving this situation, would enable those States to raise the quality of their own supervision to a satisfactory level. As this is accomplished, it is contemplated, Federal examination of banks in those States would become less necessary and gradually would be terminated. If this plans succeeds, within a relatively few years we would have a dual banking system in which State banks ordinarily would be examined only by the State authorities, and national banks by the Federal.

As I said before, it is not easy to grapple with the statements of those who oppose the pending bill. For example, how does one deal with the charge that the proposed commission would have too much power—or too little power? Is it unreasonable to place the burden on those who make these claims —to ask them to show, by chapter and verse, by facts and reasoning rather than unsupported conclusions, *how* the plan embodied in this bill would produce any of the evils they describe?

The last of the clichés I mentioned is that rarity—a fallacious argument that can be refuted by arithmetic. The objection that the bill would create "another" Federal agency simply has the facts backward; the bill actually would result in one less.

No doubt the members of this committee have read the recent Report of the President's Committee on Financial Institutions. I read the chapter on "Supervision and Examination" with particular interest. That chapter took up some of the adverse arguments I have mentioned, and—it seemed to me—demonstrated their unsoundness in polite but pointed words. Regrettably, however, but perhaps understandably in view of its composition, the President's Committee, when it reached the time for conclusion, backed most of the way down the hill it had so successfully mounted. Although recognizing the defects of the present Federal supervisory arrangement and that these defects could be corrected along the lines of the bill now before you, the Report temporized by recommending that "Existing agencies should strive to achieve greater coopera-

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tion and coordination" and that only after the present unsatisfactory system is tried for a while longer should "... consideration ... be given" to "consolidation of bank supervision." I feel sure that this committee and the Congress are in a position to act more decisively.

If we were now setting up, for the first time, a system of Federal bank supervision, no one would be so foolish, or dare to be so disingenuous, as to suggest dividing the authority among multiple agencies. By historical accident, however, we find ourselves saddled with such a system, with defects that no witness before your committee can successfully deny. Before you is a measure which can end the present confusion, duplication, inconsistencies, inequities, and waste by creating a unified system of Federal bank supervision that could not fail to be more efficient, economical, fair, and constructive.

The objections that have been advanced are found to be lacking in substance, when they are scrutinized and analyzed realistically. Quite apart from opposition due to plain lack of understanding of the proposal, there may be some who oppose it for reasons other than concern for the public welfare—for example, fear of loss of jobs, power or prestige, or of opportunities to play off one supervisor against another by shifting (or threatening to shift) from the jurisdiction of one Federal agency to another that may be more lenient. Aside from these, we find that most of the alternatives that have been offered, in lieu of action along the lines embodied in this bill, are to struggle along with the present setup, admittedly unsatisfactory, for a while longer, or to adopt some halfway measure that is only another patch, or a palliative. But there is no valid reason for delaying the needed change; the sooner the structure of bank supervision is strengthened, the sooner will the benefits be realized. This committee and the Congress have an immediate opportunity, by enacting the pending bill, to make a fundamental improvement—long overdue—in the supervision of the American banking system and, thereby, to aid in promoting our country's economic welfare.

I feel compelled to make one further comment. Of course, unification of the supervisory functions is more important than the administrative locus of the combined functions. Instead of a separate commission such as is provided in this bill, the consolidated functions could be vested, for example, in the Federal Reserve System, as was suggested by the Commission on Money and Credit of the Committee for Economic Development. In my judgment, however, this would be a decidedly inferior solution.

In the first place, the Board of Governors of the Federal Reserve System is fully burdened with functions relating to domestic and international monetary matters. It hardly has enough time, over and above that which is needed to deal effectively with this principal responsibility, to carry on supervisory activities with respect to the 1,600 state member banks alone. How it would find time to discharge, effectively, supervisory functions covering over 13,000 insured banks is beyond my imagination!

Some witnesses may tell you that bank supervision is a necessary adjunct to the Federal Reserve's responsibilities in the field of money and credit. In response, I would say that bank supervision is too important in the public interest to be treated as an adjunct to any other function. But, even more important, the basic contention is fallacious. The Federal Reserve could function as a central bank at least equally well—in my judgment, better—if it were to devote its

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full time to the formulation and execution of monetary policy and were not engaged in bank supervision at all. It could get better statistical data concerning banks from the unified Federal banking commission than it can now get from the existing supervisory agencies, because the reporting system would be uniform for all insured banks and the long and wearisome debates on whether to call for this or that item of information would be ended. If it needed to supplement that material, it would have power to make a direct call upon member banks. And, of course, it would be obliged, as it is now, to get pertinent information concerning their operations from all banks that borrow from the Federal Reserve.

In my judgment, the views of those men who engage in the formulation of monetary policy are not affected in the slightest by the fact that the man who examines a given bank happens to be on the payroll of the Federal Reserve rather than some other agency.

Finally, the argument may be advanced that if unification takes place, the agency might become the captive of the industry. All I can say in rebuttal is that I have too much faith in responsible Government officials to think that risk should be given much weight; if the argument were sound, it would follow that the Interstate Commerce Commission, the Securities and Exchange Commission, the Federal Communications Commission, and so on should each be split into two or three agencies. But if the risk does exist, its eventuation would be far more calamitous to the general welfare of the nation if the captive agency also was responsible for the formulation of monetary policy, one of the most vital functions in a free enterprise economy such as ours. Hence, in my view, the plan of unification set forth in H.R. 5874 is markedly preferable.

I wish to assure the committee that as protagonist of the idea upon which this bill is based, I would welcome a return engagement, if you should so desire, for the purpose of responding to any arguments which may be advanced in opposition or to answer, as well as I can, questions that may occur later to members of the committee.

Statement of Abbot L. Mills, Jr., Member of the 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.

I am Abbot L. Mills, Jr., a member of the Board of Governors of the Federal Reserve System, on which I have served since February 18, 1952; first, under appointment by President Truman to complete the unexpired term of office of the Honorable Marriner S. Eccles, and since February 21, 1958, under reappointment by President Eisenhower to a full term of office. Prior to service on the Board of Governors, I was engaged in commercial banking in Portland, Oregon, for 32 years. At the time of my appointment to the Board of Governors, I was First Vice President and a director of The United States National Bank of Portland. My experience in the field of banking has afforded me the opportunity to observe the workings of commercial bank supervision and regulation, both from the point of view of the supervised

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and of the supervisor. In the light of my experience, I have come to the conclusion that enactment of H.R. 5874 would not be in the public interest.

The purpose of this bill is to create a single Federal banking commission that would absorb many of the powers now vested in three existing agencies; namely, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency. The logic of the bill as regards unification and simplification of the activities of these three Federal bank supervisory and regulatory agencies has merit. In practice, however, it is open to serious criticism and objections. Objections to the proposed legislation center on fundamental principles which should be maintained inviolate.

Under the present scheme of Federal bank supervision and examination, the Board of Governors is primarily responsible for the supervision and examination of State member banks of the Federal Reserve System. The Federal Deposit Insurance Corporation is primarily responsible for the supervision and examination of all State-chartered insured banks with regard to their qualifications for insurance coverage; and the Comptroller of the Currency is primarily responsible for the supervision and examination of all national banks.

It is agreed universally that commercial banks are vested with a public interest. Therefore, the basic function of the three Federal bank supervisory agencies is to determine that the operations of the individual banks subject to their authority are such as will protect the public interest and, more particularly, their depositors through the medium of solvent loans and investments and sound banking practices.

Although the functions of the three Federal bank supervisory agencies are allocated to different areas of commercial banking, their mutual responsibilities demand, and have generally produced, a close coordination in the performance of their duties. The identification of the Federal Government with these agencies is the link in their coordinate responsibilities that brings about an informal and desirable unification of their operations. This scheme of Federal commercial bank supervision and regulation has evolved satisfactorily over the years with distinct advantages, the most important of which is that States' rights in the field of commercial banking have been shielded against the trend toward greater centralization of banking authority in the Federal Government. The principle of autonomous spheres of Federal and State commercial bank supervision must be safeguarded along lines implicit in the Federal Constitution, where separations of power and checks and balances were deliberately embedded by its framers so that no branch of the Federal Government might assume an overwhelming authority.

Enactment of H.R. 5874 would do violence to this principle because a single unified Federal commercial bank supervisory and regulatory agency would be empowered to consolidate the functions now vested in the three existing agencies. The record of centralizing power in the Federal Government has been adverse to the preservation of autonomous administrative authority at the lower levels of government. The possible danger inherent in the subject bill is that a single Federal commercial bank supervisory and regulatory agency, having nationwide authority, would sooner or later develop an incontestable power against which resistance at the State level would tend to become

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futile. In the light of history, this pattern of development would occur in spite of the fact that the proposed Federal banking commission would be administered and staffed by devoted and capable public servants. It is probable, however, that the very dedication of the agency to the performance of its duties would ultimately result in a gravitation toward arbitrary administrative policies and a well intentioned bureaucratic paternalism harmful to the existing broad-gauged and loosely joined arrangements for commercial bank supervision and examination that have proven to be an entirely feasible mechanism for attaining the same objectives sought for in H.R. 5874. In my opinion, enactment of this bill into law would disrupt time-tested and generally satisfactory commercial bank supervisory and examination procedures without producing any marked compensating advantages.

Unquestionably, there have been differences of opinion and varying approaches to the discharge of their duties on the part of the three Federal commercial bank supervisory agencies that have occurred from time to time, but never of such magnitude as could not be surmounted by frank and open-minded interchanges of opinions, ending in agreements reached through a consensus of judgments and without compromise or sacrifice of principle by any agency of its own concept of public duty. For that matter, recognition of the importance of commercial bank supervision and consequent devotion to the cause of fostering sound banking practices are factors that have inevitably forced and bound their policies into a loose but coherent uniformity.

The authority of the Board of Governors of the Federal Reserve System to examine national banks as well as State member banks and the authority of the Federal Deposit Insurance Corporaton to examine all insured banks, which includes State member banks of the Federal Reserve System, are available means to prevent any laxness or abuse of the examining power by any one of the three Federal bank supervisory agencies. Similarly, the responsibilities shared between Federal and State commercial bank supervisory authorities also serve to maintain a balance of power that is essential to the preservation of the dual banking system and respect for the legislative positions of the various States as to branch banking and bank holding companies. A single, unified Federal bank supervisory agency could become a wedge that would open up divergent Federal and State concepts of commercial bank supervision to a degree that would throw the existing separations of power off balance and, in so doing, encourage Federal aggrandizement of this function.

In relating the purposes of H.R. 5874 to the Federal Reserve System, it must be borne in mind that the member banks are the vehicle through which monetary and credit policy is conducted. As that is the case, any legislative action taken to divorce member banks from supervision and examination by the Federal Reserve System would be inimical to the effective handling of monetary and credit policy because arm's-length mechanical contact with the member banks is not a substitute for the kind of personal and intimate banking relationships that are inherent in existing examination procedures. Under the proposed legislation, mere right of access to examination reports prepared by the so-called Federal banking commission and elimination of direct examination by the Federal Reserve Banks would reduce the relationship between the member banks and the Federal Reserve System to a shad-

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owy posture, stripped of the opportunities for personal official contacts and exchanges of opinions that play an important part in the formulation of monetary and credit policy by affording an insight into the status of individual banks and the impact of their operations on the entire commercial banking system. Divorce of the examination function from the Federal Reserve System would also tend to draw the interest of member bank officials away from their Federal Reserve Banks and toward the new Federal banking commission, with a further loss of the contributions that their present contacts make in the development of System policies. Furthermore, the attraction of service on the boards of directors of the Federal Reserve Banks would be weakened and advantages lost that have been gained over the years through the structural organization of the Federal Reserve System with its judicious blend of public and private personages mutually engaged in advancing the public interest.

It is possible that Federal banking laws could be improved in some areas; for example, as regards the divisions of authority contained in the Bank Merger Act of 1960. Similarly, many of the States of the Union might do well to scrutinize their respective banking laws and to decide whether their updating to permit some form of branch banking could be undertaken and still be consistent with the preservation of existing concepts of the place of independent banking in their banking structures.

If the Congress in its wisdom should decide that Federal supervision and regulation over commercial banking should be unified and centralized in a single agency, the Federal Reserve System suggests itself as the one most appropriate, in that its responsibilities in the field of monetary and credit policy already demand a close relationship with the nation's commercial banks. Moreover, concentration of supervisory and examination authority over Federally regulated commercial banks within the Federal Reserve System would serve to maintain the present fruitful combination of public and private relationships at the administrative level that is characteristic of its official organizational structure. However, such a concentration of responsibilities in the Federal Reserve System is not recommended because, as has been stated, the present three-agency scheme of decentralized Federal bank supervision and examination is workable and well adapted to the thesis that checks and balances and separation of power among these agencies of the Federal Government are decidedly in the public interest.

Statement of George W. Mitchell, Member of the 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.

My remarks today will be addressed not to the details of H.R. 5874 but to two underlying problems in the area of bank supervision. These problems, relating to bank charters, branches, and mergers, on the one hand, and to bank examination, on the other, have a bearing on the organization of bank supervisory functions in the Federal Government.

I should like to make it clear that I am not appearing here today in opposition to the

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proposals of my colleague, Governor Robertson, that much would be gained by unifying the three arms of Federal bank supervision.

The essence of my position, however, is, first, that unification would still leave unsolved the problem of bank mergers and entry, and, second, a case can be made for unifying bank supervision in the Federal Reserve rather than in a new independent commission.

BANK STRUCTURE AND COMPETITION

Governmental regulation of the banking business, by control over chartering, branching, and merging, is divided among three agencies—each of which has responsibility for decisions involving a segment of the banking industry. This arrangement is a possible but not necessary source of inconsistent practices. Under the broad guidelines laid down in the Bank Merger Act, for example, it is conceivable that the agencies and individuals involved could accord differing weights to the statutory factors to be considered. In particular, different views of effects on competition could give rise to a pattern of inconsistent decisions among the three agencies.

This is possible. In fact, however, I believe there is nearly as much likelihood of inconsistency among decisions of a single agency as there is among those of different supervisory agencies. The reason for this is not hard to find. The seven factors which an agency must consider before determining that a merger would be in the public interest are often exceedingly difficult to judge and to weigh one against the other. In particular, reasonable and conscientious men may and do differ deeply on the interpretation and weighting of the competitive as against the banking criteria and convenience needs of the community specified in the Merger Act. There are, in consequence, many borderline cases, which may easily fall one way or the other in terms of approval or denial. In such circumstances, it is not clear that a single agency would provide a more uniform pattern of decisions than do three agencies now.

These considerations do not argue against the bill before you. They do, however, indicate that the proposal is far from a panacea for the solution of difficult problems.

As I see it, the consistency problem in the merger area, as of now, has its source more in the absence of clear guidelines than in the existence of divided authority. What is needed is a considerable effort at fact gathering and analysis, as well as a re-thinking of goals, with a view to developing a clearer set of criteria to guide decisions in individual cases.

There is much to be done in the way of fact gathering and analysis of banking markets and price behavior in those markets. For some reason this area has been much neglected in both academic and governmental studies of business organization and behavior. Just recently, the Federal Reserve has taken steps to expand its research on the subject of the market performance and market structure of commercial banking.

It is also necessary to re-think the goals of policy in governmental regulation of bank structure. It seems to me that we would be performing rather badly in our task of regulation if our thinking were dominated by uncritically-accepted guidelines appropriate to conditions long since gone. We need to recognize, for example, that in many parts of the country the structure of independent unit banks has given way to large branch and holding company systems. In each of 21 States, 4 banks or fewer (if banks held by holding companies are counted as a single bank) account for half

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of all insured commercial bank deposits, as shown in the table on page 623.

With the trend to larger banking units, we need to reappraise the notion of a fundamental conflict between safety and competition in banking. Conditions have changed greatly since the pre-Civil War wildcat banking and, indeed, since the bank failures of the 1930's. I am certainly in favor of bank soundness, but I also believe that severe restrictions on bank entry and merger decisions that emphasize safety at the expense of competition do not serve the public interest; they may be only a step away from providing monopolistic sanctuaries.

The re-thinking that should, in my opinion, occur here is to ask ourselves just how serious the conflict between safety and competition is. Are banks in our present economic environment really in danger when other banks enter their market areas to compete? Are depositors really endangered by "too much" competition?

It is my conviction that policy is and should be shifting from an excessive concern with safety to a more pro-competitive approach. Freer entry should be permitted. Finally, branches that promote competition in areas that are now sheltered from it should be authorized.

These, it seems to me, are the major problems in the area of bank structure. What I wish to emphasize is that unifying bank supervision will not by itself solve these difficult problems. Once a clearer and more reliable set of standards is developed to guide decisions on individual applications, a single agency might well be in a position to apply them more consistently than would several agencies. Similarly, a single agency might be more successful than three agencies in helping to develop a clearer and more up-to-date set of goals. I am not opposing the objectives of the bill before you. What I am suggesting is that changing the organization of bank supervision does not change the nature of the job to be done.

BANK EXAMINATION

I should like to introduce my comments on the subject of bank examination with a quotation from a speech by Chairman Cocke of the Federal Deposit Insurance Corporation:

> Recent developments in banking call for both new approaches and new methods in regard to the examination problem. For example, the size of banks and the complexity of their operations have increased tremendously over the past three decades. These changes in size and complexity impose a special obligation on the supervisory authorities to be vigilant for practices that may affect adversely the effectiveness of the traditional examination. The precise nature of the limitations on the value of the usual examination, and the consequences for bank supervision, are unknown. However, it seems doubtful that examination techniques designed for a banking system comprising many small units with few opportunities for specialization of work assignments are entirely suitable for giant banking organizations which can make effective use of highly skilled technicians. This is one of the many aspects of bank examination work that deserves further serious consideration.[1]

I believe that a reappraisal along the lines suggested by Chairman Cocke could result in a streamlining of examination procedures. For one thing, in the case of large banks, including branch and holding company systems, there is little if any need for accounting verification by Government examiners. The private interest of owners and central managers in safeguarding against mismanagement, defalcation, and incompetence coincides with the public interest. It is possible to rely on this private interest and the licensed private accountants for these purposes.

Where the public interest continues to

[1] "Bank Supervision and Examination at the Federal Level: Issues and Policy Problems," at the annual convention of the National Association of Supervisors of State Banks, Bretton Woods, N.H., Sept. 18, 1962.

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require examination of banks is in the matter of the adequacy of bank capital and of the quality of security and loan portfolios. Even here, however, security holdings, and to some extent capital adequacy, can be appraised at a distance from reports submitted by individual banks. The major function for on-the-spot examination is the appraisal of loan portfolios.

It is my contention that the judgments involved in examining bank loans are of a type that fit naturally into the responsibilities of the central bank. They are a natural extension of the central bank's concern for sound credit conditions.

These considerations regarding bank examination lend support to the proposal of the Commission on Money and Credit that bank supervisory functions be centralized in the Federal Reserve.

This proposal may also be supported on the grounds that the central bank has a strong interest in the structure and operation of the banking system, in part because the nature of that structure and operation affects responses to monetary policy. Furthermore, monetary policy gains from the intimate contact with banks that are involved in examination and responsibility for structural changes.

The major argument that has been advanced against centralizing these responsibilities in the Federal Reserve is that they would interfere with monetary policy formation. It is my view that delegation of responsibilities in accordance with established policies, if sanctioned by a revision in the law, could deal effectively with this problem.

APPENDIX

A useful descriptive measure of the structure of an industry is the so-called curve of concentration. This curve is usually constructed by placing some index, such as the percentage of total industry output, or total industry assets, or total industry employment on the vertical scale and the number of leading firms in the industry on the horizontal scale. The height of the curve above a given point on the horizontal scale, say 4, will give the percentage of the industry's total output, or assets, or employment accounted for by the largest 4 firms. Conversely, the distance from some point on the vertical scale, say 50 per cent, will give the number of firms necessary to account for 50 per cent of the industry's total output, assets, or employment.

The charts on the following page make use of this device to show concentration of deposits in leading banks by State. The percentage on the vertical scale is total deposits of a given State. Deposits constitute "capacity" to make loans and investments just as the physical plant of a steel company constitutes its capacity to produce a group of steel products. These curves might then be interpreted as the concentration of loan and investment capacity in leading banks. A very steep curve, such as that for California, indicates high concentration of loan capacity in few banks; a very gently rising curve, such as that for Iowa, indicates a low degree of concentration of loan capacity. A very humped curve, such as that for Oregon, indicates a significant disparity in the sizes of

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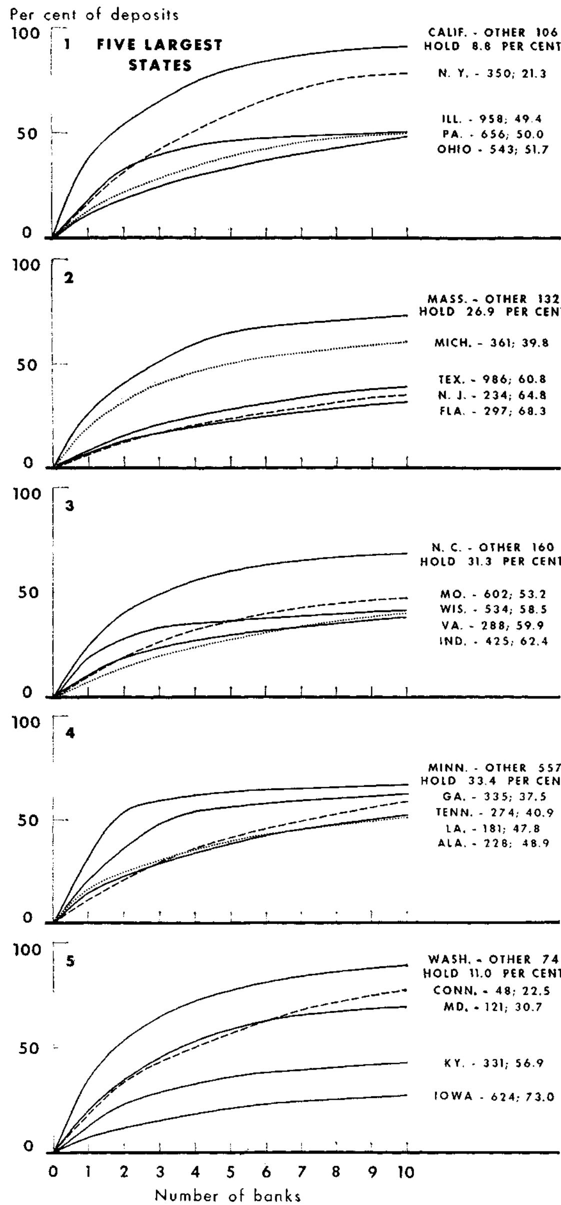
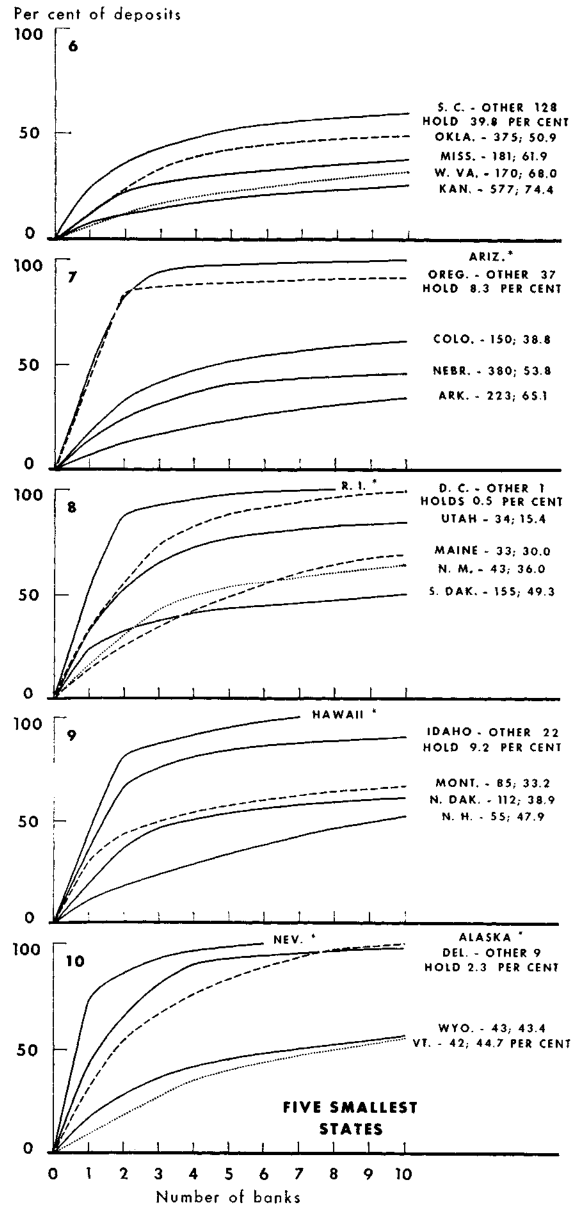
the leading and remaining banks. The label for each curve gives the State, the remaining number of banks, and the percentage of total deposits (capacity) accounted for by these remaining banks.

Care must be taken in interpreting these data. Concentration curves do not show monopoly. They are meant to show *potential* market power, which may or may not be exercised. More analysis is needed to say

CONCENTRATION OF DEPOSITS, DECEMBER 1961, IN STATES RANKED BY SIZE OF POPULATION





* No other banks in this State.

NOTE.—Based on F.R. data for insured commercial banks. Banks in District of Columbia, which ranks number 40 in population, are included in group 8.

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whether the existence of market power coincides with its use; whether high concentration is in general associated with monopoly effects such as high and rigid interest rates and low "loan output."

Concentration curves refer to a market, so that one must be very careful in drawing them up. Here we have implicitly assumed that the State lines form the boundary of "a market." This may not be a bad assumption for some States but a rather poor one for others.

DISTRIBUTION OF DEPOSITS HELD BY INSURED COMMERCIAL BANKS, DECEMBER 30, 1961

State	Percentage of total deposits						Total number of banks
	Largest bank	2 largest	3 largest	4 largest	5 largest	All other banks	
Alabama	17.9	24.9	30.2	35.5	39.6	60.4	238
Alaska	31.3	55.0	66.7	76.4	83.5	16.5	10
Arizona	46.5	82.6	94.5	96.8	97.6	2.4	10
Arkansas	7.0	13.1	17.3	20.8	23.7	76.3	233
California	40.8	54.2	64.2	74.1	81.3	18.7	116
Colorado	18.7	33.8	41.6	47.8	52.0	48.0	160
Connecticut	17.9	35.2	42.7	50.1	56.5	43.5	58
Delaware	43.3	62.8	78.4	90.2	92.1	7.9	19
District of Columbia	32.1	55.8	75.0	82.8	89.0	11.0	11
Florida	7.0	13.8	17.1	19.6	22.1	77.9	307
Georgia	20.6	36.0	48.0	54.2	56.3	43.7	345
Hawaii	42.7	81.6	87.2	91.9	95.8	4.2	7
Idaho	36.1	66.8	74.9	81.2	84.3	15.7	32
Illinois	17.4	33.9	39.5	43.9	46.4	53.6	968
Indiana	10.1	19.4	23.9	26.7	29.5	70.5	435
Iowa	6.8	11.3	14.7	17.7	20.4	79.6	634
Kansas	7.4	11.5	14.9	17.2	19.2	80.8	587
Kentucky	11.7	23.1	28.7	32.8	36.1	63.9	341
Louisiana	14.3	22.0	28.7	34.1	38.8	61.2	191
Maine	14.1	25.4	34.7	42.0	48.9	51.1	43
Maryland	20.9	34.8	45.1	53.7	61.5	38.5	131
Massachusetts	28.3	39.7	49.6	59.0	65.0	35.0	142
Michigan	21.3	31.3	40.5	46.0	49.9	50.1	371
Minnesota	30.5	56.4	59.0	61.5	64.0	36.0	567
Mississippi	12.6	23.1	26.2	28.4	30.3	69.7	191
Missouri	9.7	19.2	26.4	31.7	35.9	64.1	608
Montana	30.6	43.6	49.2	54.6	57.8	42.2	95
Nebraska	14.7	24.5	30.8	37.1	41.3	58.7	390
Nevada	72.9	85.6	93.1	97.1	98.6	1.4	7
New Hampshire	12.2	18.5	24.3	29.5	34.1	65.9	65
New Jersey	6.3	12.2	16.8	20.3	23.4	76.6	244
New Mexico	17.0	30.8	43.6	49.8	54.0	46.0	53
New York	16.8	31.6	42.6	51.2	59.1	40.9	360
North Carolina	24.4	40.5	48.7	56.0	59.6	40.4	170
North Dakota	18.9	36.6	46.4	50.3	53.8	46.2	122
Ohio	11.6	18.2	24.3	29.8	33.6	66.4	553
Oklahoma	12.0	23.4	33.1	39.9	42.6	57.4	385
Oregon	43.0	84.9	86.9	88.1	88.9	11.1	47
Pennsylvania	13.4	21.4	28.2	34.2	39.0	61.0	666
Rhode Island	53.8	88.5	92.3	95.4	98.0	2.0	8
South Carolina	24.6	36.2	43.1	48.3	51.9	48.1	138
South Dakota	24.3	32.9	37.3	41.5	43.3	56.7	165
Tennessee	11.2	20.5	29.0	36.2	41.5	58.5	284
Texas	8.2	15.4	21.0	24.6	28.1	71.9	996
Utah	32.4	53.0	65.6	73.0	77.5	22.5	44
Vermont	9.5	18.6	27.5	35.7	39.8	60.2	52
Virginia	7.3	14.0	19.6	23.8	27.6	72.4	298
Washington	35.9	55.4	63.3	69.5	75.6	24.4	84
West Virginia	6.2	11.8	17.1	20.0	22.6	77.4	180
Wisconsin	19.9	27.3	33.8	35.0	36.2	63.8	544
Wyoming	17.2	28.5	36.0	41.8	44.8	55.2	53

NOTE.—Holding companies consolidated within States.

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