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PUBLIC INTEREST CHALLENGES TO BANKERS

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PUBLIC INTEREST CHALLENGES TO BANKERS

As you complete the 1976 session at the Virginia-Maryland Bankers School, it seems an appropriate time to direct your attention to the changing environment of banking and the need for greater awareness of public interest matters by the banking profession. Clearly the political, economic, and financial arena for banking has changed markedly in the past five years. There is closer Congressional scrutiny of the banking industry, required disclosure of information which most bankers held extremely confidential as recently as two years ago, and a very sharp move toward greater competition.

One of the greatest changes in the environment within which bankers must operate today is the changing picture of the credit industry itself. A part of this is the increased competition from other financial institutions and, to an even greater extent, from nonfinancial institutions. But beyond the increased competition, bankers are faced with a major shift in their credit-granting environment. Included in such shifts are greater pressures for allocation of credit, the reactions of the banking industry itself to the excesses of the 1970 to 1973 period, especially in real estate financial credit, the increased number of failures of large banks and the disclosures of implied wrong-doing by members of the banking profession. While increased public scrutiny and adverse reaction to banking difficulties has developed, a form of conservatism has swept over the banking industry, almost to the point where as one banker put it to me the other day: "Our loan officers are not making loans based on their evaluation of the credit but based on whether the examiner will criticize them." I suggest that this is a poor way of determining whether or not to extend credit and probably means that the community is not well served.

There indeed has been a series of significant shifts in the environment for banking in the past five years. Not only have changes developed in attitudes toward credit and the willingness of people to accept the banker's word for matters relating to finance, but there has been a rather significant change in the structure of banking. Banks shifted rather rapidly toward bank holding company structures and toward enlarging their sphere of influence into permissible non-bank activities. Competition was and is the name of the game, and with that competition has come an increased emphasis upon efficiency, upon achieving greater equity among customers and depositors and a continuing effort to improve the over-all financial position of the banking units.

Let me start our discussion by reviewing some of the forces which I think the students of the Virginia-Maryland Banking School will soon face, if you have not already done so, in your future banking careers. Among the principal changes in the environment for banking has been an increased public scrutiny and a new awakening of the public interest in financial organizations. The definition, scope and intensity of that public interest are matters about which you and your associates need to be greatly concerned. If Congress, or the President, or the bank regulators are the only ones to define the public interest, banks and banking will have an entirely different flavor than if you and your associates and organizations contribute to the definition. Recognize that more and more regulators are becoming involved in the banking industry--the Securities and Exchange Commission, Federal Trade Commission, and even the White House Telecommunications Office have begun to make their influence felt in the banking industry, in addition to the Justice Department and State and Federal authorities who have traditionally played a role in regulating banks. For some of the new entrants into bank regulation, banking is just another industry to be treated the same as other industries in its dealing with the public. One feature of this is the requirement to disclose its position with sufficient clarity that investors and depositors can make fully informed judgments on the strengths and weakness of particular banks. Some of these new regulators discount the argument that banking data should be confidential to protect customer relationships, or to maintain confidence in the integrity of the institution. So you, as the bankers who must live under this environment should be actively participating in the definition of the public interest in this field. Is it true that investors need the kind of information which the SEC is now considering? Especially, is the potential reporting of all non-conforming loans, and even those which management believes might become nonconforming, necessary for a good evaluation of a particular bank? Or is it desirable or necessary to the public interest and to an informed investor's judgment that banks be required to provide five-year weighted average reports on investments, deposits, loans, and interest? Should banks be required to report loans by country of borrower or by industry within that foreign country? Much of whether it is decided if such information is needed is obviously conditioned by the objectives of such regulation. To some of the regulators, the objective is clear--it must be full and complete disclosure; to others there are competing objectives of rights of privacy, confidentiality of customer relations, burdens of reporting, and potentials of excessive costs for credit and reduced numbers of credit outlets.

Still another public interest problem lies in the procedures, monitoring, and policies needed to achieve non-discriminatory access to credit. The fundamental public interest objective is that credit be extended without discrimination. The problems arise in the means to assure this and the potentials for interference with the legitimate measuring of credit worthiness, the degree and type of monitoring required, and the responsibility and probable success of isolating patterns of discrimination by aggregating the data. To some the sole consideration seems to be total assurance of non-discrimination, to others the degree of burden of reporting, the measuring task, the problem of meaningful aggregation of data, and the possibility of accentuation of racial, sex, or religious discrimination by forced recordation are important. Is it really necessary that records of all potentially discriminatory characteristics of each borrower be recorded?

To most bankers extension of credit includes evaluation of a definable and acceptable risk at a price yielding a reasonable and competitive rate of return. Does the public interest demand equal treatment even to the possibility of interference with sound credit measurement?

Another public interest question lies in the desirability or necessity for credit allocation. Many of the more serious challenges to banking recently have related to credit allocation. To some in Congress and elsewhere, it is inconceivable that banks should not allocate credit to the housing industry. To others, credit allocation for housing is merely a first step toward credit allocation for other needy borrowers, including decaying downtown neighborhoods, minority business, urban redevelopment, and environmental programs. Again whose perception of the objective is to govern? Some believe the objective is the establishment of a public interest priority and then the allocation of credit of that priority. This approach would mean that market factors will play a much reduced role from those of the regulators, Congress, and others who are defining the public interest. So if you wish to have some input into the future of your credit-granting processes, you should be actively participating in the formulation of the objectives and means toward achieving them.

You should help determine the answers to the following: should high priority credit needs be met by direct government lending, subsidies of interest, tax exemption for borrower or lender, or regulatory fiat? Should market interest rate allocation be subsidiary to legislative determination of credit extensions? Should special-purpose financial institutions be created to serve the public interest priority categories?

Another significant change in banking environment has been the pressure for increased competition in the financial industry. This public interest movement has been manifested in a number of different ways including the passage of the Bank Holding Company Act, the administration of that Act by the Federal Reserve, the increased competitive demands for disclosure to improve consumers' ability to shop for credit among different credit-granting institutions, the Congressional push for the FIA and FINE bills and especially the push for increased competitive authority for the nonbank financial institutions. To some, competition is a substitution for regulation, but to others, competition is an adjunct or complement to regulation.

For either group competitive pressures and the monitoring of those pressures has increased the reporting burden of commercial banks and other financial institutions, perhaps to the level where the costs of credit are building a base of steadily higher interest rates and perhaps even in a few instances to the detriment of the over-all availability of credit. As bankers, you should be in the forefront of those attempting to shape the destiny of your industry over the coming years. You should be participating with your associations in defining the limits of erosion in your particular industry or evaluating the degree that competitive forces should be held in check to assure continued safety and soundness while still providing the benefits of a competitive environment. Competition means many things to many people. It may mean to improve the return for the small saver whose funds have been kept almost at hostage by the banking and financial institutions. It may mean an early return to payment of interest on demand deposits to assure the consumer a return on his funds no matter where they are kept. Competition could be viewed as the tool to achieve credit at the lowest possible rates of interest in a truly nondiscriminatory environment. Competition may mean assuring the public that bankers are not making an unreasonable profit and are participating in the support of their community credit needs. Competition could even be viewed as the means of channeling credit into areas supported by governmental subsidy to be the most attractive as a profit maximization position.

There are some who view competition with some severe reservations in their minds. They view competition as an adjunct to regulation, not a substitution therefor. They view competitive forces as a means of keeping many banks in the field of community support but they view certain elements of competition as dangerous to the potential safety and soundness of the industry. To others competition and regulation are two parts of a total control program, where regulation should deal with unsafe and unsound banking practices, whereas competition in an on-going sense would ensure the funds for continued growth of the economy and an improved credit channeling system moving funds from areas of excess to areas of deficiency. To others free competition raises a danger of concentrated economic and credit power for a few. Competitive forces to these people mean the potential of excessive concentration and therefore a force to be limited and severely controlled.

Perhaps I have not even touched your own position on competition. Perhaps it is, as a banker said to me, "Competition determines my policies. If the banker down the street makes loans at five per cent, I must make them at five per cent, and if the competitor raises his rates on certificates of deposit, I must raise mine." Perhaps your definition of competition is a definition of market protection so that you and those other financial institutions in your immediate neighborhood will be able to compete for the loans and deposits of the community without interference from outside institutions. Perhaps your view of competition is the broadest one, with freedom of entry and freedom of failure in the banking industry. Whatever your definition or your position, I urge you to make your voices heard in defining the competitive environment within which the banking industry must operate in the years to come because both banking competition and regulation are to a considerable extent reflective of a well-defined, enunciated, and evaluated public interest.

Finally, I would mention to you that public interest challenge of the broader national interest to banking. After all, our economy is built on a credit base and only with the sound provision of credit, taking of acceptable risks and the prudent and careful management of those risks will our economy advance and provide the wherewithal for an improved standard of living in our nation. If bankers are to adopt, as many did over the past year, a philosophy that contraction is our best policy, the economy of the nation will suffer and those of us who deal with the broad data on the nation's economic and financial health will see continued slippage between that which the economy produces and that which the economy could produce. I urge you then to take a broader role and a broader view of your banking industry and of your bank's role in that industry.

I urge you to consider not only the narrow realm of your own community's interest and your own profit picture but also the sound and prudent expansion of credit for the growth of the economy as a whole. Part of that broader look must be a position with regard to the monetary authority of the United States. While many of you in this room probably represent banks who are not members of the Federal Reserve System, you are still a member of the banking industry and of the financial industry of the United States, and perhaps more importantly, you are a member of an industry whose future is inextricably entwined into the future of our great nation. Critical to that future is the ability of the nation's central bank to establish and maintain sound policies and procedures for over-all credit control. If the Federal Reserve is to do its job to handle the nation's credit supplies in the way which provides for a noninflationary growth of the nation, then it must remain an independent agency with strong and enduring ties of over-sight by Congress but with an independence of policy permitting it to render its best judgment of the credit needs of the economy, not the political needs of a few. Your voice and continuing support of this independent evaluation and judgment is needed more than ever because the political forces of interference and influence seem to be growing while the nation's opportunities for growth in a noninflationary pattern may be diminishing.

In summary, the banking challenges of tomorrow are, to a great extent, the challenges of political participation in defining, measuring and evaluating the public interest. Your success in this will bring enduring rewards to your industry, your bank, and you.

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