NEWS RELEASE

FEDERAL DEPOSIT INSURANCE CORPORATION

WASHINGTON, D. C. 20429

Telephone: 393-8400
Br. 221

FOR RELEASE TO P.M. PAPERS, MONDAY, JUNE 1, 1964 PR-46-64 (5-28-64)

Examination of the problems confronting the banking industry must be made without parochialisms, and on a broad perspective, Joseph W. Barr, Chairman of the Federal Deposit Insurance Corporation, declared this afternoon.

Addressing the annual convention of the American Institute of Banking at the Sheraton Park Hotel in Washington, D. C., Mr. Barr said: "My responsibility as a public official in thinking about these difficult and perplexing banking problems is to develop and retain broad perspectives, to define my questions closely and carefully in this framework and to weigh alternative answers and solutions with my mind free of parochialisms."

Pointing out that 1965 "could be a year of decision" in the area of banking legislation, Mr. Barr declared that there are contrasting viewpoints, public and private, including the "compartments" into which the financial community is divided. He emphasized "I am not asking any member of the commercial banking community to forego his democratic right to press home his viewpoint with vigor and imagination."

Mr. Barr declared "basic conflict between the public and the private interests in considering an important policy question should not be viewed as a fatal consideration in our political structure. Quite the contrary, this is an essential feature of a democracy. Where the democratic philosophy of government prevails, every person has the right, if not the obligation, to

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present his viewpoint clearly and in full detail. Sound public policy is achieved by the process of reconciling the major interests underlying these many divergent viewpoints."

Mr. Barr emphasized that policy decisions must take into consideration all elements within the banking industry, plus nonbanking financial institutions. "A policy decision is good only to the extent that it serves the public interest in its broadest terms," he declared.

"But there are even broader implications to be taken into account," he added. "Commercial banking policy cannot be considered in a vacuum, without regard for its implications to public policy. The president of a bank in any small town in my home State of Indiana is caught up and entangled in both the national and the international flow of events. Ultimately, conclusions with respect to interest regulations as well as many other troublesome policy issues may well be determined by a balancing of the domestic and international implications of alternative choices."

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MONDAY, JUNE 1, 1964

PERSPECTIVE IN BANKING

Address of

JOSEPH W. BARR, CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION
Washington, D. C.

at the

ANNUAL CONVENTION

of the

AMERICAN INSTITUTE OF BANKING

at the

Sheraton Park Hotel

Washington, D. C.

Monday, June 1, 1964

FOR RELEASE TO P.M. PAPERS, MONDAY, JUNE 1, 1964

PERSPECTIVE IN BANKING

About two weeks ago in Vienna, the Under Secretary of the Treasury for Monetary Affairs, The Honorable Robert Roosa, delivered an address entitled "The Potentialities of Our International Payments System." In this address, Secretary Roosa advanced no hard and fast solutions for the intricate problems encompassed by his subject matter. Nevertheless, he identified the central issues and set them in perspective. The result of this endeavor was an altogether remarkable disclosure of his mental processes in this effort to analyze a complex situation and to arrive at viable answers to difficult questions.

I found Mr. Roosa's treatment of his subject matter to be most refreshing. So often it seems to me there is a tendency for Government Officials to be reluctant to reveal the considerations that have led to their decisions in policy making. As the Secretary demonstrated, the public is entitled to something more than the brevity of a legend carved in stone to support conclusions of far reaching importance.

That it is important to trace in full detail considerations bearing upon a question of public interest has been emphasized many times in my own experience. I served in the U. S. Treasury for three years and my responsibility was principally involved with legislation in the Congress. Quite early I discovered that no one can explain the intent of a legislative proposal unless he has participated actively in the discussions and arguments that have preceded the formulation of policy. To be effective in these circumstances it is essential to outline for the Congressmen the processes of reasoning that supported the conclusions to be embodied in legislation.

Today in the course of my remarks, I shall outline the considerations bearing upon the exercise of regulatory authority over the payments of interest on deposits in banks. These controls are stated in Regulation No. 329 promulgated by the Federal Deposit Insurance Corporation and Regulation Q of the Board of Governors of the Federal Reserve System. My presentation of these considerations will follow the pattern established by Secretary Roosa in his discussion of international liquidity. Though I do not intend to present definitive conclusions with respect to the regulation of interest, I shall endeavor to place the discussion in its appropriate setting and to establish the necessary reference points for perspective. My own reactions will take this total situation into account.

As a public official whose authority is derived ultimately from the Congress, it is my responsibility to consider questions presented for determination in their broadest context. Inevitably, I know, this leads to conflict when the same problems or issues are viewed in a narrower frame of reference. Each individual banker, for example, will tend to personalize his own consideration. Each bank is a business which can only be successful if it shows a record of profitable operations. If the banker did not translate consideration of a public question into its consequences for his own business, he would not be a good banker and the results would indeed be fatal to our institutional arrangements.

This basic conflict between the public and the private interests in considering an important policy question should not be viewed as a fatal contradiction in our political structure. Quite the contrary, this is an essential feature of a democracy. Where the democratic philosophy of government prevails, every person has the right, if not the obligation, to present his viewpoint clearly and in full detail. Sound public policy is achieved by the process of reconciling the major interests, underlying these many divergent viewpoints.

With respect to a subject matter as inherently controversial as the regulation of interest on deposits in banks, one would not expect any unanimity in the views held by the various segments of the financial community.

Large banks with relatively small ratios of time or savings deposits and with broad access to the market for international loans could be expected to press for relaxation of the regulatory controls on the payment of interest. On the other hand, it is equally natural for smaller banks with a relatively large volume of savings accounts and little or no access to foreign loans to look on any relaxation of Regulation Q or our Regulation No. 329 as a worsening of their competitive environment.

The conflicts in this situation are not fully contained within the banking industry. The nonbanking financial institutions, such as the savings and loan associations, make up another segment in the financial community that is concerned with changes in interest rate regulations. To be sure, my own immediate responsibility extends only to insured banks, but I am deeply concerned with the consequences of policy decisions that may extend into other important areas. A policy decision is good only to the extent that it serves the public interest in its broadest terms.

But there are even broader implications to be taken into account. Commercial banking policy cannot be considered in a vacuum, without regard for its implications to public policy. The president of a bank in any small town in my home State of Indiana is caught up and entangled in both the national and the international flow of events. Ultimately, conclusions with respect to interest regulations as well as many other troublesome policy issues may well be determined by a balancing of the domestic and international implications of alternative choices.

Now, to put the issue into perspective, I want to trace briefly the history of interest rate regulations.

Since the 1930's, banks have been prohibited by law from paying interest on demand deposits. Interest rates payable on time and savings deposits were fixed by regulation at the time of banking reform legislation in 1933 and 1935. The Federal Reserve and the Federal Deposit Insurance Corporation were authorized to make these regulations. Recently, these interest rate limitations have been questioned.

Competition in banking and the need to devise means for containing or mitigating its harmful effects is the central theme throughout the debates which eventually led to the regulation of interest paid by banks to their depositors. This competition appears in two different settings. In the first place, there was the interbank aspect of the problem, as individual banks in the large financial centers drew money away from those in other communities. Secondly there was competition among all banks for deposits.

For many years, it had been generally recognized that speculators were using bank funds through the call loan mechanism to conduct their operations in the financial markets. One proposal of long standing, the prohibition of interest on interbank deposits, was rejected by the draftsmen of the legislation in 1913 establishing the Federal Reserve System. They felt, instead, that the decentralization of reserves in 12 Federal Reserve banks offered a workable remedy for the drainage of bank funds from the interior of the country to large eastern financial centers, notably New York. Unfortunately, as it turned out, the Act did not stem the flow as had been hoped. Funds continued to gravitate to the eastern seaboard. In the 1920's the New York Call Money Market offered banks in the interior an attractive way to invest idle reserves at a good rate of return in the most liquid type of assets. But at the same time, the small businessman was complaining about the difficulty of obtaining funds when he wished to borrow from his local bank.

Following the disaster of the early 1930's it was not surprising that reform legislation included a prohibition on the payment of interest on demand deposits. This was strongly urged by Senator Glass. To be sure, the argument would be applicable to both time and demand deposits, provided that the funds came from bankers, but the prohibition was applied only to demand deposits and the source of funds was ignored.

Banking reform legislation in 1933 and 1935 definitely focused attention on interest as a cost of doing business by prohibiting interest payments on demand deposits and regulating the rates paid on time deposits. The reform legislation lifted this heavy demand deposit cost element out of banking and, in the case of time and saving deposits, eased competition. When permissible rates are low, banks have every inducement to follow conservative policies in the management of assets. Since banks are unique, in that liabilities generated to acquire assets become part of the medium of exchange, the prohibition of interest on demand deposits may be a desirable safeguard for the economy. These are the deposits subject to check and, as money, they should be supported only through the acquisition of bankable assets. As the pressure on banks for earnings increases -- and the necessity to pay interest on deposits is one of the most effective ways to increase pressure -- standards for asset selection deteriorate.

Now how does this historical background help us in answering the questions being raised today about the regulation of interest? Hopefully, a review of the background will provide us with an historical perspective.

In the first place, advocates of change with respect to control of interest on bank deposits will certainly be constrained in their views by their personal situations. All banks are under pressure to earn money and the nature of the pressure will be determined by the circumstances of the bank in question For example, the bank with 90 percent of its deposits in the demand category is much less likely to be concerned with changes in the permissible rate of interest on time and savings accounts than is another bank with its deposits more or less equally divided between the two categories The problem, in any case, can be reduced to the consideration of interest payments as a cost, and the prospects for attracting funds, that is, taking advantage of a competitive situation, if interest rate payments could be altered.

But, in addition, the financial community breaks up into compartments. As in the past, so today managements of large banks in the urban center may be expected to have views on interest rate regulation which differ from those, let us say, of suburban areas or those serving agricultural communities, to mention only two other groups. On reflection, you can think of many other compartments in our banking system represented by opposing views on a variety of subjects equally as troublesome as interest rate regulation.

Moreover, there are compartmental groupings in the financial community which pit banking against non-banking institutions. Savings and loan associations are competing for funds that might otherwise remain in the savings departments of commercial banks. Mutual savings banks, investment trusts, insurance companies, and other institutions all contend for savings.

The interrelationships between all financial institutions that attract funds, both banking and non-banking, are important. For example, in July 1963 when maximum interest rates payable on time deposits were raised to present levels, the action was aimed specifically at minimizing short-term capital outflows prompted by higher interest rates prevalent in other countries. At the time, the Board of Governors of the Federal Reserve and the Federal Deposit Insurance Corporation noted that short-term outflow of funds contributed to the substantial deficit in the balance of payments during the second quarter of the year.

Finally, there are considerations of importance which stem directly from the management of the Federal debt. For many years the interest coupons on United States Government bonds have been fixed by statute at a maximum of four and one-quarter percent. A vigorous effort was made by the Treasury to remove this limitation in 1959, but the Congress was unwilling to change the law. In 1961, however, the Attorney General ruled that the limitation applied only to the coupon rate and the bonds could be sold or exchanged at discounts which would in fact yield a higher rate of return. Nevertheless, the law is in the nature of a basic limitation in the field of interest rate regulation which deserves consideration in this discussion. It is my political judgment that the Congress would not alter the four and one-quarter percent ceiling.

Recently interest rate regulation has received careful study by well qualified groups such as the members of the President's Committee on Financial Institutions. In addition, many public spirited individuals and associations have considered the subject. Almost without exception, interest rate limitations on time and savings deposits have been recommended on a standby basis only -- in other words, ceiling rates would be established only when necessary. However, it is likely, with authority so phrased, that at the present time interest rates would be controlled.

These are the issues which I must balance and weigh as a public official. To be perfectly candid, I do not think that any legislation or action on this subject will develop during this year. However, I do believe that next year could be a year of decision in this controversial area. I am not asking any member of the commercial banking community to forego his democratic right to press home his viewpoint with vigor and imagination. My personal experience has indicated that spirited and intelligent controversy usually produces good policy. My intent today is merely to outline to you the factors that I must consider before I come to a conclusion. I hope you will agree with me that my responsibility as a public official in thinking about these difficult and perplexing banking problems is to develop and retain broad perspectives, to define my questions closely and carefully in this framework and to weigh alternative answers and solutions with my mind free of parochialisms

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