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ADDRESS BY
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BEFORE THE
SEMINAR ON CONTEMPORARY PROBLEMS IN BUSINESS AND BANKING
MONTGOMERY, ALABAMA
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[Contemporary problems in business and banking.]

PLAYBOY MAGAZINE BEGAN AN ARTICLE IN ITS FEBRUARY ISSUE WITH THE ASSESSMENT "AMERICA'S BANKS ARE IN TROUBLE." THE TITLE OF THAT ARTICLE WAS "BANKS ON THE BRINK." NUMEROUS OTHER POPULAR JOURNALS, NOT KNOWN FOR THEIR COVERAGE OF THE FINANCIAL WORLD -- INCLUDING HARPER'S, ESQUIRE, THE NEW YORK MAGAZINE AND THE VILLAGE VOICE -- HAVE PUBLISHED ARTICLES RAISING QUESTIONS ABOUT THE SOUNDNESS OF OUR BANKING SYSTEM. READING SUCH COVERAGE I AM OFTEN REMINDED OF THIS FAMILIAR EXCERPT FROM A CHILDREN'S STORY:

"ONE DAY HENNY PENNY WAS PICKING UP CORN IN THE FARMYARD WHEN AN ACORN FELL OUT OF A TREE AND STRUCK HER ON THE HEAD. 'GOODNESS GRACIOUS ME!' SAID HENNY PENNY, 'THE SKY IS FALLING. I MUST GO AND TELL THE KING.'"

I DO NOT BELIEVE THAT THE SKY IS FALLING ON OUR INDUSTRY OR ON THE AMERICAN ECONOMY ANY MORE THAN IT WAS FALLING IN THAT STORY. HOWEVER, I DO BELIEVE THAT, WHEN RECENT MONTHS AND THE COMING TERM OF THE 94TH CONGRESS ARE REVIEWED BY ECONOMIC HISTORIANS, THEY MAY SEE EFFECTS ON BANKING SUBSTANTIALLY MORE SIGNIFICANT THAN THOSE WROUGHT BY THE ACORN WHICH STRUCK HENNY PENNY.

EVEN THOUGH MANY OF THE CONCLUSIONS REACHED IN THE PRESS ARE EXAGGERATED, EVENTS OF THE PAST EIGHTEEN MONTHS HAVE SERVED TO FOCUS THE ATTENTION OF BANKERS, BANK REGULATORS AND THE CONGRESS ON SOME VERY REAL PROBLEMS. THE FAILURES OF THE FRANKLIN NATIONAL BANK AND OTHER LARGE INSTITUTIONS DEMONSTRATED THAT SIZE ALONE DOES NOT INSURE SAFETY. TOGETHER WITH THE SHOCKING LOSSES OF SOME FOREIGN EXCHANGE DESKS, THE PUBLICITY WHICH HAS BEEN GIVEN BANK RELATIONS WITH REITS AND W. T. GRANT'S, THE OVERHANG OF OTHER LOAN LOSSES THAT WILL UNDOUBTEDLY OCCUR BEFORE THE RECESSION ENDS, AND THE DISTRESS MERGERS OF SECURITY NATIONAL BANK AND BEVERLY HILLS NATIONAL BANK, THESE FAILURES HAVE UNDERSCORED THE RISKS INHERENT TO SUCH FUNDAMENTAL

FEATURES OF MODERN BANKING AS INTERNATIONAL OPERATIONS, THE HOLDING COMPANY AND LIABILITY MANAGEMENT BANKING. THUS, ALTHOUGH THE BROAD BASE OF PUBLIC CONFIDENCE IN OUR SYSTEM OF BANKING AND BANK SUPERVISION REMAINS UNSHAKEN, BANKING'S IMAGE IS SOMEWHAT TARNISHED.

MOREOVER, THE ECONOMIC OUTLOOK FOR THE REMAINDER OF 1975 AND 1976 CONTINUES TO BE MORE GLOOMY THAN ANY SINCE THE THIRTIES. PRESIDENT FORD IN HIS ECONOMIC REPORT OF THE PRESIDENT STATED:

"THE ECONOMY IS IN A SEVERE RECESSION. UNEMPLOYMENT IS TOO HIGH AND WILL RISE HIGHER. THE RATE OF INFLATION IS ALSO TOO HIGH, ALTHOUGH SOME PROGRESS HAS BEEN MADE IN LOWERING IT."

ARTHUR OKUN, RESPECTED ECONOMIST AND FORMER CHAIRMAN OF THE PRESIDENT'S COUNCIL OF ECONOMIC ADVISORS, IS REPORTED TO HAVE USED THE TERM "DEPRESSION" IN REFERRING TO THE CONDITION OF THE ECONOMY. IN THIS CONTEXT, IT IS WELL TO RECALL THAT HISTORY SUGGESTS THAT SIGNIFICANT CHANGES IN OUR FINANCIAL

SYSTEM USUALLY OCCUR IN RESPONSE TO PERIODS OF ECONOMIC INSTABILITY OR CRISIS.

ALONG WITH THE STRAINS OF RECENT MONTHS AND THE PROSPECT OF FURTHER INSTABILITY, COMPETITIVE INNOVATION AND AGGRESSIVENESS BY SOME GROUPS OF INSTITUTIONS MAY ALSO PROVIDE IMPETUS FOR CONGRESSIONAL ACTION. THE DEVELOPMENT AND IMPLEMENTATION OF ELECTRONIC FUNDS TRANSFER SYSTEMS AND THE COMPTROLLER'S RULING IN THIS AREA; FEAR OF HOLDING COMPANY COMPETITION ON THE PART OF SOME INDUSTRIES; THE INTERSTATE PRESENCE OF LARGE HOLDING COMPANY SYSTEMS; THE AMBITIONS OF MANY BANKERS WITH RESPECT TO THE SECURITIES FIELD; THE ABILITY OF THRIFT INSTITUTIONS TO COMPETE DIRECTLY WITH COMMERCIAL BANKS; AND THE RAPID GROWTH AND RESULTING ECONOMIC POWER OF THE LARGEST HOLDING COMPANIES WILL ALL PROVIDE GRIST FOR THE LEGISLATIVE MILL, AS CONGRESS ATTEMPTS TO BALANCE THE VARIOUS INTERESTS SEEKING TO MAINTAIN OR ENHANCE THIS COMPETITIVE POSITION.

FINALLY, AND MOST IMPORTANT IN ASSESSING THE PROSPECTS FOR SIGNIFICANT LEGISLATION, THE CONGRESS JUST ELECTED IS LIKELY

TO BE THE MOST REFORM-MINDED AND CONSUMER-ORIENTED IN THE NATION'S HISTORY. IN THE AFTERMATH OF WATERGATE AND CONFRONTED WITH ECONOMIC CONDITIONS WHICH SEEM TO CRY FOR ACTION, THIS CONGRESS IS LIKELY TO ASSERT ITSELF WITH RESPECT TO BOTH THE ADMINISTRATION AND VARIOUS INTERESTS.

AS YOU KNOW, IN BOTH THE SENATE AND THE HOUSE, NEW CHAIRMEN -- SENATOR PROXMIRE AND CONGRESSMAN REUSS -- HEAD THE RESPECTIVE BANKING COMMITTEES. EACH IS A KNOWLEDGEABLE AND VIGOROUS LEGISLATOR AND EACH IS KNOWN TO BE LESS THAN SATISFIED WITH THE PERFORMANCE OF THE INDUSTRY OR THE AGENCIES IN CERTAIN AREAS. ALSO, IT SHOULD BE NOTED THAT FAR GREATER COOPERATION MIGHT BE EXPECTED BETWEEN THE TWO COMMITTEE CHAIRMEN THAN HAS OCCURRED IN THE RECENT PAST, THEREBY ENHANCING THE PROSPECTS FOR THE PASSAGE OF SIGNIFICANT LEGISLATION.

IN ADDITION TO CHANGES IN THE LEADERSHIP AND ORGANIZATION, THERE HAS, OF COURSE, BEEN CONSIDERABLE TURNOVER IN THE MEMBERSHIP OF BOTH HOUSES WITH THE NEW MEMBERS TENDING TO BE SOMEWHAT YOUNDER AND MORE LIBERAL. IN THE HOUSE OF REPRESENTATIVES,

FOR EXAMPLE, THERE ARE 92 NEW MEMBERS. IN THE BEST OF TIMES, SUCH CIRCUMSTANCES WOULD PRODUCE FERMENT. IN THE CURRENT ECONOMIC AND POLITICAL CLIMATE, SIGNIFICANT CHANGE IN THE REGULATORY ENVIRONMENT IS LIKELY. I WILL TOUCH ON SOME OF THE AREAS WHERE CHANGE MIGHT BE EXPECTED.

BANKERS SHOULD ANTICIPATE A GREATER EMPHASIS ON THE VARIOUS ASPECTS OF CONSUMER PROTECTION. IF FOR NO OTHER REASON, THE PRESENCE OF MR. PROXMIRE AS CHAIRMAN OF THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS WOULD ASSURE IT.

THIS PROCESS IS ALREADY UNDERWAY. AS A RESULT OF LEGISLATION ENACTED DURING THE LAST CONGRESS, WE AT THE FDIC ARE IN THE PROCESS OF STRUCTURING AND STAFFING AN OFFICE OF BANK ^{Consumer} CUSTOMER AFFAIRS WHICH WILL BE DIRECTLY RESPONSIBLE TO THE BOARD OF DIRECTORS AND WILL BE CHARGED WITH IMPLEMENTING THE PROVISIONS OF THIS ACT AS WELL AS PROMOTING CONSUMER INTERESTS. NOTWITHSTANDING THE FDIC'S TRADITIONAL FOCUS ON SAFETY AND SOUNDNESS, BANKERS SHOULD EXPECT THAT THE FDIC AND THE OTHER AGENCIES WILL PROTECT THE RIGHTS OF CONSUMERS JUST AS VIGOROUSLY

AS IT PURSUES THE GOAL OF CAPITAL ADEQUACY.

THE RELATIONSHIP BETWEEN BANKS AND THEIR CUSTOMERS IS LIKELY TO ALTER EVEN FURTHER IN 1975 WITH THE ESTABLISHMENT OF THE LONG-DISCUSSED AGENCY FOR CONSUMER ADVOCACY. SIMILAR LEGISLATION NARROWLY MISSED ENACTMENT IN EACH OF THE LAST THREE SESSIONS OF CONGRESS. THE CURRENT PROPOSAL, WHICH HAS BEEN REPORTED OUT OF THE SENATE GOVERNMENT OPERATIONS COMMITTEE, PROVIDES FOR THE ESTABLISHMENT OF AN INDEPENDENT AGENCY "TO REPRESENT THE INTERESTS OF CONSUMERS BEFORE FEDERAL AGENCIES AND COURTS, RECEIVE AND TRANSMIT CONSUMER COMPLAINTS, DEVELOP AND DISSEMINATE INFORMATION OF INTEREST TO CONSUMERS, AND PERFORM OTHER FUNCTIONS TO PROTECT AND PROMOTE THE INTERESTS OF CONSUMERS." WITH A FEW EXCEPTIONS, THE AGENCY WOULD BE EMPOWERED TO INTERVENE IN ALL PROCEEDINGS BEFORE FEDERAL AGENCIES AND COURTS IN WHICH CONSUMERS HAVE AN INTEREST.

IN SHORT, THE AGENCY WOULD BE THE ADVOCATE OF THE CONSUMER WITHIN GOVERNMENT-- PRESUMABLY COUNTERBALANCING THE ESTABLISHED VOICES OF OTHER INTERESTS. BECAUSE OF THE EXPLICITLY

PARTISAN ROLE OF THE AGENCY, IT WOULD NOT MAKE RULES OR OTHERWISE ACT AS A REGULATOR. GIVEN THE MOOD AND THE MAKE-UP OF THE CONGRESS, BANKERS SHOULD EXPECT PASSAGE OF THIS LEGISLATION IN 1975.

ANOTHER PIECE OF LEGISLATION WHICH RECEIVED MUCH ATTENTION IN THE 93RD CONGRESS -- THE ADMINISTRATION VERSION OF THE HUNT COMMISSION RECOMMENDATIONS -- HAS BEEN REINTRODUCED IN THE SENATE AS THE FINANCIAL INSTITUTIONS ACT OF 1975. I AM SURE THAT I NEED NOT REVIEW IN DETAIL THE SUBSTANCE OF THIS PACKAGE: EXPANDED DEPOSIT AND THIRD-PARTY PAYMENT POWERS FOR THRIFT INSTITUTIONS; EXPANDED LENDING AUTHORITY FOR BOTH THRIFT INSTITUTIONS AND NATIONAL BANKS; REVISION OF THE TAX LAWS TO PLACE ALL FINANCIAL INSTITUTIONS ON AN EQUAL FOOTING; PROVISION FOR STOCK THRIFT INSTITUTIONS AT THE FEDERAL LEVEL; A PHASE-OUT OF REGULATION Q; EXPANDED POWERS FOR CREDIT UNIONS AND A GENERAL OVERHAUL OF FEDERAL STATUTES PERTAINING TO THEM; AND CERTAIN OTHER PROVISIONS PROVIDING FOR GREATER FLEXIBILITY IN THE COMPETITION AMONG FINANCIAL INSTITUTIONS. WITH THE EXCEPTION

OF SIGNIFICANT REVISION OF THE PROVISIONS PERTAINING TO REGULATION Q, THE BILL PROPOSED TO THIS SESSION OF CONGRESS BY THE ADMINISTRATION EMBODIES THE PROPOSALS I HAVE ALREADY MENTIONED.

UNFORTUNATELY, ALTHOUGH SOME LEGISLATION ALONG THESE LINES MAY BE ENACTED IN THE NOT-TOO-DISTANT FUTURE, THE PROSPECTS FOR ACTION THIS YEAR AND PERHAPS EVEN NEXT MUST BE CONSIDERED DIM. THIS ASSESSMENT FLOWS FROM THE FACT THAT SENATOR PROXMIRE HAS ALREADY SUGGESTED THAT HE HAS "RESERVATIONS ABOUT THE LEGISLATION," AND FROM THE FACT THAT CONGRESSMAN ST. GERMAIN'S SUBCOMMITTEE ON FINANCIAL INSTITUTIONS, SUPERVISION, REGULATION AND INSURANCE DOES NOT APPEAR LIKELY TO MOVE ON THIS BILL UNTIL IT HAS CAREFULLY CONSIDERED BOTH THE SPECIFIC PROPOSALS IN THE BILL AS WELL AS OTHER RELATED ISSUES SUCH AS AGENCY RESTRUCTURING. ACCORDINGLY, ONE SHOULD NOT EXPECT ACTION OF THE FINANCIAL INSTITUTIONS ACT UNTIL 1976 AND THEN IT IS FAIR TO EXPECT THAT THERE WILL BE SIGNIFICANT MODIFICATIONS.

AS I HAVE INDICATED ON MANY OCCASION, I AM IN FULL SUPPORT OF LEGISLATION ALONG THE LINES PROPOSED BY THE HUNT COMMISSION.

I SHOULD NOTE AT THIS POINT THAT I DO HAVE ONE SERIOUS DISAGREEMENT WITH THE ADMINISTRATION PACKAGE AS INTRODUCED THIS TERM. AMONG THE CHANGES THE ADMINISTRATION HAS MADE IS THE EXTENSION OF AUTHORIZATION TO SET DEPOSIT RATE CEILINGS UNDER REGULATION Q FOR FIVE AND A HALF YEARS. IN THE ORIGINAL VERSION OF THE BILL, A GRADUAL PHASE-OUT OF DEPOSIT RATE CEILINGS WAS CALLED FOR OVER FOUR YEARS, BEGINNING EIGHTEEN MONTHS AFTER THE BILL WAS ENACTED. ACCORDING TO NEWSPAPER REPORTS, THIS CHANGE IN THE LEGISLATIVE PACKAGE WAS DESIGNED TO MAKE IT MORE POLITICALLY ACCEPTABLE TO THE THRIFT INDUSTRY. WHILE ONE CAN APPRECIATE THE ADMINISTRATION'S SENSITIVITY TO POLITICAL CONSIDERATIONS IN SEEKING TO OBTAIN THE PASSAGE OF AN IMPORTANT PIECE OF LEGISLATION, ITS DECISION TO COMPROMISE IS DISAPPOINTING.

IT HAS BEEN DEMONSTRATED TIME AND TIME AGAIN THAT REGULATION Q CEILINGS ARE DISCRIMINATORY AND CAUSE SEVERE

DYSFUNCTIONS IN OUR FINANCIAL MARKETS. IT HAS ALSO BEEN ARGUED WITH FORCE THAT BY VIRTUALLY ELIMINATING COMPETITION FOR DEPOSITS, THE REGULATION Q CEILINGS INCREASE THE NEED FOR BANKERS TO RESORT TO MORE VOLATILE MONEY MARKET INSTRUMENTS, THEREBY INCREASING THE LEVEL OF RISK IN THE SYSTEM. ALSO, BY DENYING SMALL SAVERS ACCESS TO INTEREST RATES WHICH A FREELY FUNCTIONING MARKET WOULD SET, REGULATION Q CEILINGS MAY HAVE ACTUALLY DISCOURAGED SAVINGS WHICH MIGHT OTHERWISE HAVE BEEN PUT IN PRODUCTIVE USE.

IN ADDITION TO THE FACT THAT INTEREST RATE CEILINGS HAVE BEEN COUNTER-PRODUCTIVE IN PURELY ECONOMIC TERMS, THERE IS ANOTHER SIDE OF REGULATION Q WHICH HAS RECEIVED TOO LITTLE ATTENTION, EVEN BY THE MOST OUTSPOKEN ADVOCATES ON THE PART OF CONSUMERS. REGULATION Q CONSTITUTES A SUBSIDY OR SHELTER TO THE HOUSING AND THRIFT INDUSTRIES AND TO MORTGAGE BORROWERS WHICH IS FUNDED BY WHAT CONSTITUTES A TAX ON LOW AND MIDDLE INCOME SAVERS. TOTALLY APART FROM THE FACT THAT THE DEVICE HAS DEMONSTRABLY FAILED TO PROVIDE A STABLE FLOW OF HOUSING,

IT IS WRONG THAT THE BURDEN FOR PROVIDING THIS SUBSIDY SHOULD FALL ON THOSE WHO CAN LEAST AFFORD IT, HOWEVER LAUDABLE THAT GOAL. WITH INFLATION AT PRESENT LEVELS, THE INEQUITY IS ESPECIALLY CRUEL.

I'M WELL AWARE THAT ABRUPT ELIMINATION OF REGULATION Q, WITHOUT MEASURE TO AVOID DISLOCATION, WOULD BE IRRESPONSIBLE. SUCH MEASURE SHOULD NOT, HOWEVER, PROVIDE EXCUSE TO DELAY THE ELIMINATION OF THIS UNJUST AND INEFFICIENT INTERFERENCE WITH THE MARKET MECHANISM. I SINCERELY HOPE THAT BOTH BANKERS AND MEMBERS OF CONGRESS WILL COME TO APPRECIATE THE EXTENT TO WHICH THE ATTEMPT TO ALLOCATE CREDIT TO HOUSING, TO PROTECT THE THRIFT INDUSTRY AND TO EFFECT MONETARY POLICY THROUGH REGULATION Q IS INEFFICIENT, INEFFECTIVE, AND, MOST IMPORTANTLY, UNJUST. IT WOULD INDEED BE IRONIC IF THIS WERE IGNORED BY CONGRESS IN THIS PERIOD OF HIGH INTEREST IN CONSUMER PROTECTION.

ONE SUBJECT WHICH HAS GENERATED WIDESPREAD INTEREST AND WHICH IS LIKELY TO RECEIVE FAVORABLE CONSIDERATION IS THE PAYMENT OF INTEREST ON CERTAIN FUNDS OF THE UNITED STATES.

A NUMBER OF BILLS HAVE BEEN INTRODUCED ON THIS SUBJECT, INCLUDING ONE IN THE SENATE BY CHAIRMAN PROXMIRE AND ANOTHER IN THE HOUSE BY CONGRESSMAN PATMAN FOR HIMSELF AND CHAIRMAN REUSS. THE PROXMIRE BILL WOULD PROVIDE FOR PAYMENT OF INTEREST ON SUCH FUNDS "AT A RATE NOT LESS THAN ONE PERCENTAGE POINT BELOW THE EFFECTIVE FEDERAL FUNDS RATE," AND WOULD CHARGE THE APPROPRIATE AGENCY WITH ENFORCING THE PROVISION THROUGH ITS CEASE AND DESIST POWERS. THE REUSS/PATMAN PROPOSAL ALSO PROVIDES FOR THE PAYMENT OF INTEREST AT A RATE NOT LESS THAN ONE PERCENT BELOW THE FEDERAL FUNDS RATE; HOWEVER, IT ALSO CONTAINS A PROVISION REQUIRING THE COMPENSATION OF BANKS FOR SERVICES PERFORMED FOR THE GOVERNMENT. GIVEN THE INTEREST OF THE RESPECTIVE CHAIRMEN IN THE PASSAGE OF LEGISLATION, BANKERS SHOULD EXPECT ACTION IN THIS AREA AND SHOULD PREPARE THE MOST EFFECTIVE CASE POSSIBLE FOR INCLUSION OF THE SORT OF "COMPENSATION" PROVISION SUGGESTED IN THE PATMAN/REUSS PROPOSAL.

A HOTLY DEBATED ISSUE WHICH IS LIKELY TO RECEIVE THE ATTENTION OF CONGRESS IN THE COMING WEEKS IS THE PROPOSED

MORATORIUM ON THE FURTHER DEVELOPMENT OF ELECTRONIC FUNDS TRANSFER SYSTEM. AS YOU PROBABLY KNOW, A NATIONAL COMMISSION WAS CREATED BY CONGRESS TO ENGAGE IN A THOROUGH STUDY OF EFTS AND ITS RAMIFICATIONS AND TO SUBMIT COMPREHENSIVE RECOMMENDATIONS TO CONGRESS CONCERNING REGULATION IN THE AREA BY DECEMBER OF 1976. TO DATE, NO CHAIRMAN HAS BEEN APPOINTED, NOT ALL POSITIONS ON THE COMMISSION HAVE BEEN FILLED AND NO STAFF HAS BEEN APPOINTED. YET IMPLEMENTATION OF VARIOUS SYSTEMS HAS PROCEEDED APACE. AND, OF COURSE, MORE SIGNIFICANT THAN THE PROJECTS OF ANY INDIVIDUAL BANK OR GROUPS OF BANKS HAS BEEN THE COMPTROLLER'S RULING THAT SUCH FACILITIES ARE NOT "BRANCHES" WITHIN THE MEANING OF THE McFADDEN ACT THEREBY FREEING NATIONAL BANKS FROM THE GEOGRAPHIC RESTRICTIONS OF STATE LAW IN DEVELOPMENT OF THESE SYSTEMS.

CONCERNED THAT DEVELOPMENTS IN THIS AREA, AND ESPECIALLY THE COMPTROLLER'S RULING, WOULD SIGNIFICANTLY ALTER THE SHAPE OF COMPETITION BEFORE CONGRESS HAS THE BENEFIT OF THE COMMISSION'S ADVICE, SENATOR PROXMIRE AND REPRESENTATIVE ST.

GERMAIN INTRODUCED BILLS IN THEIR RESPECTIVE CHAMBERS CALLING FOR A MORATORIUM ON DEVELOPMENTS IN THIS AREA. HEARINGS ON SENATOR PROXMIRE'S BILL WERE HELD ON MARCH 14, 1975. THE BILL HAS BEEN STRONGLY BACKED BY THE IBAA WHICH BELIEVES THAT THE SMALLER INDEPENDENT BANKERS WILL BE PLACED AT A SIGNIFICANT DISADVANTAGE IF EFTS DEVELOPMENT CONTINUES UNREGULATED. THE BILL HAS BEEN VIGOROUSLY OPPOSED BY THE COMPTROLLER, THE FEDERAL RESERVE BOARD, THE FEDERAL HOME LOAN BANK BOARD, THE ANTITRUST DIVISION OF THE JUSTICE DEPARTMENT, THRIFT INDUSTRY GROUPS, AND THE AMERICAN BANKERS ASSOCIATION.

THE FDIC'S POSITION ON THIS BILL, IN WHICH I CONCUR, WAS SUBMITTED TO THE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS ON MARCH 14. A SUMMARY OF OUR VIEWS STATED:

"WE OPPOSE THE TOTAL MORATORIUM ON EFT FACILITIES REQUIRED BY THE PRESENT TERMS OF THE BILL AND WOULD URGE INSTEAD EXPLICIT CONGRESSIONAL GUIDANCE ON WHETHER OR NOT SUCH FACILITIES CONSTITUTE "BRANCHES" UNDER PRESENT FEDERAL LAW FOR PURPOSES OF APPLYING

THE PROVISIONS OF STATE LAW WHICH MIGHT GOVERN THEIR LOCATION AND APPROVAL. IF THIS APPEARS NEITHER DESIRABLE NOR FEASIBLE AND THE CONGRESS BELIEVES SOME MORATORIUM SHOULD BE ENACTED WHILE IT AWAITS THE REPORT OF THE NATIONAL COMMISSION OR JUDICIAL DETERMINATION OF THE "BRANCH" QUESTION, WE RECOMMEND THAT THE MORATORIUM NOT APPLY TO THE ESTABLISHMENT OF SUCH FACILITIES ACROSS STATE LINES (UNLESS, POSSIBLY, SUCH FACILITIES ARE AFFIRMATIVELY AUTHORIZED BY EXPLICIT STATUTE IN THE STATE OF INTENDED LOCATION.)

I AM OPTIMISTIC THAT CONGRESS WILL ADDRESS THE KNOTTY ISSUE OF WHETHER THESE FACILITIES ARE "BRANCHES" AS WE HAVE SUGGESTED. I DO BELIEVE, HOWEVER, THAT IF ANY MORATORIUM IS ENACTED IT WILL ALLOW A CERTAIN DEGREE OF DEVELOPMENT TO PROCEED IN THIS AREA SO THAT THE COMMISSION WILL HAVE A BODY OF EVIDENCE ON WHICH TO BASE ITS ASSESSMENTS.

YOU ARE NO DOUBT FAMILIAR WITH THE LEGISLATION ORIGINALLY

INTRODUCED BY CHAIRMAN REUSS AS THE "LOWER INTEREST RATE ACT OF 1975," WHICH WOULD HAVE SET A SPECIFIC GOAL FOR THE CONDUCT OF MONETARY POLICY AND WOULD HAVE IMPLEMENTED A PROGRAM OF MANDATORY CREDIT ALLOCATION. AFTER DIVISION OF THE TWO PROPOSALS INTO SEPARATE BILLS AND EXTENSIVE AND OFTEN HEATED HEARINGS, THE EFFORT RESULTED IN A CONGRESSIONAL RESOLUTION, NOT HAVING THE FORCE OF LAW OR REQUIRING THE PRESIDENT'S SIGNATURE, CALLING UPON THE FED TO CONDUCT MONETARY POLICY SO AS TO LOWER INTEREST RATES AND TO MAKE PERIODIC REPORTS TO CONGRESS. THE PROPOSAL FOR MANDATORY CREDIT ALLOCATION WAS SCHEDULED IN COMMITTEE.

LIKELY TO APPEAL TO CONGRESS AS A MEANS OF DIRECTING THE FLOW OF RESOURCES ARE DIRECT SUBSIDIES TO AID THE DEPRESSED HOUSING INDUSTRY. THE EMERGENCY MIDDLE INCOME HOUSING ACT, WHICH HAS ALREADY PASSED THE HOUSE, WOULD PROVIDE A SUBSIDY TO FAMILIES WHOSE INCOMES DO NOT EXCEED 120 PERCENT OF THE MEDIAN INCOME OF THEIR AREA AND WHO WISH TO PURCHASE HOMES WHOSE VALUE IS BELOW A SPECIFIED AMOUNT. THE PURPOSE OF THIS LEGISLATION IS TO "REDUCE HIGH MORTGAGE INTEREST COSTS TO MIDDLE-INCOME

FAMILIES AND TO STIMULATE EMPLOYMENT IN THE HOMEBUILDING INDUSTRY DURING THE CURRENT EMERGENCY PERIOD. . . ." It is INTERESTING TO OBSERVE THAT THIS MORE TRADITIONAL FORM OF CREDIT ALLOCATION IS PERFECTLY ACCEPTABLE TO MANY OF THE MOST VEHEMENT OPPONENTS OF CHAIRMAN REUSS' PROPOSALS. IT ANY EVENT, ABSENT A DRAMATIC REVERSAL OF TRENDS IN THE HOUSING INDUSTRY, I WOULD EXPECT THE EARLY PASSAGE OF SOME LEGISLATION ALONG THESE LINES.

ANOTHER ISSUE LIKELY TO RECEIVE THE ATTENTION OF CONGRESS IS THAT OF AGENCY REFORM. CHAIRMAN BURNS HAS INDICATED THAT THE FEDERAL RESERVE BOARD IS LIKELY TO COME FORWARD LATER IN THE YEAR WITH COMPREHENSIVE RECOMMENDATIONS. THERE IS SOME INDICATION THAT CONGRESSIONAL LEADERSHIP WILL BE RECEPTIVE TO THE IDEA OF RESTRUCTURING THE AGENCIES, ALTHOUGH NOT NECESSARILY ALONG THE LINES PROPOSED BY THE FED. FOR MY OWN PART, I HAVE NOT RESOLVED IN MY OWN MIND PRECISELY HOW THE FEDERAL SYSTEM OF BANK SUPERVISION AND REGULATION SHOULD BE RESTRUCTURED. IT DOES SEEM CLEAR TO ME, HOWEVER, THAT EFFICIENCY AND COMMON SENSE DEMAND REORGANIZATION ALONG FUNCTIONAL LINES. FOR EXAMPLE,

I FIND IT DIFFICULT TO JUSTIFY THE TRIPARTITE DIVISION OF EITHER EXAMINATION AND SUPERVISORY FUNCTIONS OR OF THOSE FUNCTIONS WHICH DEAL WITH STRUCTURE, SUCH AS CHARTERING, MERGERS, HOLDING COMPANY ACQUISITIONS, AND BRANCH AND FACILITY APPROVALS. SIMILARLY, FUNCTIONS DEALING WITH TROUBLED AND FAILING INSTITUTIONS MIGHT ALSO BE CONSOLIDATED.

CONSOLIDATION ALONG FUNCTIONAL LINES COULD BE ACCOMPLISHED IN ONE OF TWO WAYS. FIRST, ALL SUPERVISORY AND REGULATORY FUNCTIONS MIGHT BE COMBINED IN A SINGLE AGENCY. THIS AGENCY MIGHT BE THE FEDERAL RESERVE, AS GOVERNOR SHEEHAN HAS SUGGESTED, OR IT MIGHT BE ANOTHER AGENCY EITHER PRESENTLY EXISTING OR NEWLY CREATED, AS FORMER BOARD GOVERNOR ROBERTSON PROPOSED SOME YEARS AGO. ALTERNATIVELY, THE EXISTING AGENCIES MIGHT BE RETAINED WITH CERTAIN FUNCTIONS SHIFTED AMONG THE AGENCIES TO ELIMINATE OVERLAP AND MINIMIZE CONFLICT. IT IS INTERESTING TO NOTE THAT GOVERNOR BUCHER, ONLY LAST MONTH, SUPPORTED THE ROBERTSON PROPOSAL, SUGGESTING THAT THERE MAY BE SIGNIFICANT DISAGREEMENT AT THE FED ON THIS ISSUE.

I HAVE NOT YET DETERMINED WHICH ALTERNATIVE I FAVOR. HOWEVER, AS I HAVE INDICATED ELSEWHERE, I WOULD HAVE VERY GRAVE RESERVATIONS ABOUT A REORGANIZATION WHICH INVESTED IN ONE INDEPENDENT FEDERAL AGENCY SOLE AUTHORITY BOTH TO ADMINISTER MONETARY POLICY AND TO REGULATE OUR NATION'S 15,000 BANKS. I SAY THIS FOR TWO REASONS. FIRST OF ALL, THE EXPERIENCE OF RECENT MONTHS HAS MADE OBVIOUS THE IMPORTANCE OF CAREFUL AND EXPERT EXECUTION OF MONETARY POLICY AS WELL AS THE COST THAT COULD RESULT FROM ITS MISMANAGEMENT. IT SEEMS TO ME THAT THE AGENT OF THIS DELICATE AND CRITICAL FUNCTION SHOULD NOT BE ASSIGNED FURTHER DUTIES OF ALMOST EQUAL MAGNITUDE AND COMPLEXITY. IN ADDITION, IT SHOULD NOT BE FORGOTTEN THAT ALTHOUGH THE PRESENT SYSTEM IS UNSATISFACTORY IN MANY RESPECTS, IT DOES PROVIDE CERTAIN CHECKS AND BALANCES. WHILE OTHERS MAY DIFFER, I WOULD FIND VERY DISTURBING THE VESTING OF SUCH PERVASIVE POWER OVER THE ECONOMY IN A SINGLE AGENCY.

EITHER AS PART OF AGENCY RESTRUCTURING OR SEPARATELY, CONGRESS WILL UNDOUBTEDLY EXAMINE VERY CLOSELY THE OPTIONS

AND PROCEDURES PRESENTLY AVAILABLE IN DEALING WITH FAILING AND TROUBLED BANKS AS WELL AS EVALUATING THE CONDUCT OF EACH OF THE AGENCIES IN CONNECTION WITH THE USNB, FRANKLIN, AND SECURITY NATIONAL CASES. HEARINGS ON THESE CASES HAVE ALREADY BEEN SCHEDULED BEFORE CONGRESSMAN ST. GERMAIN'S SUBCOMMITTEE ON FINANCIAL INSTITUTIONS, SUPERVISION, REGULATION AND INSURANCE. THE FED HAS FORMALLY PROPOSED LEGISLATION WHICH WOULD ALLOW FOR THE INTERSTATE ACQUISITION OF BANKS HAVING MORE THAN \$500 MILLION IN ASSETS BY BANK HOLDING COMPANIES. AND WE AT THE FDIC ARE PRESENTLY ENGAGED IN A COMPREHENSIVE REVIEW OF THE AREA WHICH MAY LEAD TO A PACKAGE OF RECOMMENDATIONS IN THE LATE SPRING OR EARLY SUMMER.

WHILE THE FED BILL PURPORTS ONLY TO DEAL WITH A NARROW PROBLEM, IT IS WELL TO SPEND A FEW MINUTES FOCUSING ON SOME OF THE ISSUES WHICH IT RAISES BECAUSE, IN MY JUDGMENT, THE BILL TOUCHES ON SOME OF THE MOST BASIC QUESTIONS FACING THE INDUSTRY AND THE CONGRESS IN THE COMING MONTHS AND YEARS. ESSENTIALLY THE BILL HAS TWO FACETS. FIRST, THE INITIAL PROVISION OF THE

BILL WOULD ALLOW THE BOARD TO ACT MORE PROMPTLY IN APPROVING HOLDING COMPANY ACQUISITIONS IN EMERGENCY SITUATIONS. THIS PROVISION MERELY PARALLELS THE BANK MERGER ACT'S EMERGENCY APPROVAL PROVISIONS, AND IT IS QUITE SENSIBLE AND CLEARLY SHOULD BE ENACTED. THE HEART OF THE BILL, HOWEVER, LIES IN ITS PROVISIONS WHICH WOULD GIVE THE FED VIRTUALLY UNFETTERED DISCRETION TO APPROVE INTERSTATE ACQUISITION OF LARGE DISTRESSED BANKS BY HOLDING COMPANY SYSTEMS. ALTHOUGH THE EVIDENCE SUGGESTS THAT THE PROPOSAL MAY ADDRESS A REAL NEED, NAMELY, THAT IN SOME MARKETS, THERE MAY BE FEW IF ANY POTENTIAL ACQUIRERS OF A DISTRESSED INSTITUTION AS A RESULT OF MARKET STRUCTURE OR STATE RESTRICTIONS ON BRANCHING, IT MAY BE OBJECTIONABLE IN A NUMBER OF WAYS.

FIRST OF ALL, IT SHOULD BE RECOGNIZED THAT THE BILL INVOLVES A FURTHER EROSION OF STATE PROHIBITIONS OF THE OPERATION OF DEPOSIT-TAKING FACILITIES BY OUT-OF-STATE BANK ORGANIZATIONS. NEEDLESS TO SAY, INTERSTATE BANKING ALREADY EXISTS TO SOME DEGREE -- THROUGH LOAN PRODUCTION OFFICES, CORPORATE SUBSIDIARIES

AND AFFILIATES, EDGE ACT COMPANIES AND OTHER MEANS. NEVERTHELESS, THE BILL TAKES SUCH DEVELOPMENTS A SIGNIFICANT STEP FURTHER WITHOUT EITHER DIRECTLY ADDRESSING THE DESIRABILITY OF INTERSTATE BANKING GENERALLY OR SETTING FORTH SPECIFIC STANDARDS FOR DETERMINING WHICH AMONG THE POTENTIALLY MANY MERGER PARTNERS WOULD GET WHAT IN MANY CASES COULD BE A SIGNIFICANT ECONOMIC PLUM. WHILE THIS LATTER FLAW MIGHT BE REMEDIED BY AMENDMENT INCLUDING SUCH STANDARDS, BANKERS SHOULD NOT IGNORE THE FACT THAT THIS LEGISLATION REPRESENTS ANOTHER STEP TOWARD FULL-SCALE INTERSTATE BANKING.

SECONDLY, IT IS UNCLEAR WHY THIS PROCESS SHOULD BE INVOKED AND THE KEY DETERMINATIONS MADE BY THE FEDERAL RESERVE BOARD RATHER THAN THE PRIMARY SUPERVISOR OF THE DISTRESSED BANK AND/OR BY THE FDIC WHICH INSURES AND MUST LIQUIDATE THE BANK IF IT FAILS. THE BILL WOULD, IN EFFECT, INVOLVE THE SHIFT OF A SIGNIFICANT POWER -- THE PRIMARY RESPONSIBILITY FOR LARGE DISTRESS CASES -- TO THE FEDERAL RESERVE BOARD.

THIRD, EVEN THOUGH THE EXPRESS PROVISIONS OF THE LEGISLATION

DO NOT NECESSARILY PRECLUDE FAILURE AND A PAYOUT OF A BANK OVER \$500 MILLION IN TOTAL ASSETS, THEY STRONGLY SUGGEST A PUBLIC POLICY OF DE FACTO 100 PERCENT INSURANCE FOR ALL DEPOSITORS AND CREDITORS IN BANKS EXCEEDING THE CUT-OFF. AT THE VERY MINIMUM, ENACTMENT OF THIS LEGISLATION WOULD IMPLY CONGRESSIONAL RECOGNITION OF TWO CLASSES OF BANKS AND MAKE THOSE IN THE CLASS OVER THE CUT-OFF AT LEAST marginally SAFER THAN THOSE UNDER THE CUT-OFF.

THIS TIERING IS TROUBLESOME FOR TWO REASONS. IT HAS BEEN ARGUED THAT LARGE DEPOSITORS AND OTHER INVESTORS ALREADY PERCEIVE THE VERY LARGEST FINANCIAL INSTITUTIONS TO BE INHERENTLY SAFER THAN OTHERS, CAUSING RESOURCES TO FLOW INTO THESE INSTITUTIONS FROM SMALLER INSTITUTIONS AND ENABLING LARGER INSTITUTIONS TO RAISE CAPITAL WITH GREATER EASE. IF THIS IS TRUE, ADOPTION OF A NATIONAL POLICY TO PREVENT FAILURE OF THE LARGEST INSTITUTIONS CAN BE EXPECTED TO EXACERBATE THE CURRENT DISADVANTAGED POSITION OF SMALLER INSTITUTIONS. IT SHOULD BE NOTED THAT THE PROBLEM WOULD BE GREATEST NOT FOR "SMALL"

INSTITUTIONS BUT RATHER FOR THE MEDIUM-SIZED BANK (SAY \$100-\$500 MILLION) WHICH IS DEPENDENT TO SOME EXTENT ON REGIONAL AND NATIONAL MONEY AND CAPITAL MARKETS. THIS SHOULD BE OF SPECIAL CONCERN TO THE FDIC, GIVEN THE INCREASING NUMBER OF OUR INSTITUTIONS WHICH FALL INTO THIS CATEGORY (FOR EXAMPLE, AMERICAN BANK AND TRUST, NORTHERN OHIO BANK AND WESTLANDS BANK). APART FROM PRACTICAL OBJECTIONS, ONE MIGHT BE TROUBLED BY THE IMPLICATIONS THAT WHEN CERTAIN BUSINESSES BECOME VERY LARGE, (1) THEY CANNOT BE ALLOWED TO FAIL, AND (2) EXISTING PUBLIC POLICY WILL BE BENT TO PREVENT SUCH FAILURE.

FOURTH, THOSE WHO HAVE OPPOSED 100 PERCENT INSURANCE FOR ALL DEPOSITORS AND CREDITORS WOULD SEEM LIKELY TO OPPOSE THIS LEGISLATION ON THE GROUND THAT IT WILL REDUCE THE DISCIPLINE ON RISK-TAKING (FOR BANKS ABOVE THE CUT-OFF) WHICH MARKETS IMPOSE. ONE MIGHT ARGUE THAT, UNLESS SUPERVISORY DISCIPLINE REPLACES MARKET DISCIPLINE, LARGE BANKS MIGHT WELL UNDERTAKE GREATER RISK THAN THEY WOULD HAVE UNDER DIFFERENT CIRCUMSTANCES, WITH THE CONSEQUENCE THAT THE POSSIBILITY OF FAILURE IS ENHANCED

IN THE VERY INSTITUTIONS WHERE FAILURE IS VIEWED AS HAVING SUCH ADVERSE EFFECTS THAT IT REQUIRES SPECIAL HANDLING.

AND, FINALLY, CHAIRMAN BURNS' LETTER TO CONGRESSMAN REUSS STATES: "IF, HOWEVER, THE BOARD'S CURRENT RECOMMENDATION HAD BEEN PART OF THE LAW LAST SUMMER, THE NUMBER OF POTENTIAL BIDDERS WOULD HAVE BEEN SIGNIFICANTLY LARGER, AND THE PROCESS OF FINDING A RESOLUTION TO FRANKLIN'S PROBLEMS WOULD HAVE BEEN SHORTENED CONSIDERABLY." WHILE I SUPPOSE THAT THE ARGUMENT COULD BE MADE THAT THE AVAILABILITY OF BANK OF AMERICA AND OTHER LARGE, NON-NEW YORK INSTITUTIONS WOULD HAVE SHORTENED THE NEGOTIATIONS (BECAUSE THE BIDDERS COULD HAVE BEEN PLAYED OFF AGAINST ONE ANOTHER MORE EASILY), THIS ARGUMENT IS HIGHLY SPECULATIVE AT BEST. INDEED, IF THE SELECTION OF AN ACQUIRER IS TO BE ON OTHER THAN AN ARBITRARY BASIS, THE NEGOTIATION AND BIDDING PROCESS IS LIKELY TO BE LONGER RATHER THAN SHORTER AS A RESULT OF THE LARGER NUMBER OF INSTITUTIONS IN THE FIELD.

THE PROSPECTS FOR THIS LEGISLATION ARE DIFFICULT TO ACCESS. I WOULD HOPE, HOWEVER, THAT CONGRESS WILL REJECT THIS

PIECEMEAL APPROACH AND WILL ATTEMPT TO DEVELOP A MORE SYSTEMATIC APPROACH WHICH DOES LESS VIOLENCE TO PROHIBITIONS ON INTERSTATE BANKING AND WHICH TREATS ALL BANKS EQUALLY.

AS THIS DISCUSSION SUGGESTS, THE OUTLOOK FOR THE 94TH CONGRESS IS UNCERTAIN. HOWEVER, MAJOR CHANGE FOR THE BANKING INDUSTRY AND ITS REGULATORS IS INEVITABLE. AS I STATED AT THE OUTSET, SIGNIFICANT CHANGES IN OUR FINANCIAL SYSTEM RESULT FROM PERIODS OF ECONOMIC CRISIS. THE ECONOMIC INSTABILITY OF OUR TIMES SHOULD LEAD THE INDUSTRY, THE AGENCIES AND CONGRESS TO IMAGINATIVE YET DISCIPLINED RESPONSE. WE MUST SEEK TO UNDERSTAND AND MANAGE THE FORCES AT WORK INSTEAD OF MERELY REACTING IN TRADITIONAL WAYS TO THE DILEMMAS WHICH NOW CONFRONT US. DURING PERIODS OF ABUNDANCE AND RAPID EXPANSION, IT IS POSSIBLE AND QUITE NATURAL TO AVOID OR POSTPONE HARD CHOICES, TO TOLERATE WASTE AND INEFFICIENCY, AND TO BENEFIT FROM THE OPERATION OF FORCES ONLY DIMLY UNDERSTOOD. WE NO LONGER HAVE THAT LUXURY.

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