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Address by [on financial institution Reform and the Federal chartering option for mutual savings banks]

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at the

Annual Conference of the
National Association of Mutual Savings Banks
San Francisco, California

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It is a great pleasure to be with you and, of course, to be here in San Francisco. Because this is my first opportunity to speak with you as a group, I will touch briefly on several issues which I know to be of interest rather than focusing in detail on a single subject. I anticipate a lively and cooperative dialogue in the coming months as we work closely with you to address what seem to me complex and challenging questions. I do not purport to have all the answers and, therefore, will welcome and actively solicit your views.

One subject which has been of concern to us all in recent years, regardless of perspective, has been that of financial institution reform. I supportec the recommendations of the Hunt Commission and the goals embodied in the Financial Institutions Act. I was disappointed at the demise of this legislati in the last Congress. I continue to be of the view that a financial system involving more direct competition among financial intermediaries and greater reliance on the direct operation of free markets is a more efficient and effective way to allocate deposit funds. Moreover, I believe that the Hunt Commission was essentially correct in its strong recommendations that financial restructuring should not be accomplished piecemeal but rather in the context of a comprehensive legislative package designed to provide as equitably as possibl for transition to the new structure.

Nevertheless, events since publication of the Hunt Commission recommendations in 1971 indicate that supporters of comprehensive financial reform were perhaps a bit naive. Financial reform is not going to be enacted as a comprehensive and balanced package at the Federal level -- at least not in the foreseeable future -- a judgment confirmed by the leadership in Congress. Ironically, however, many facets of the package have been achieved through developments in the marketplace and at the State level. Reflection on these developments provide valuable lessons: First, about the politics of financial legislation; and second, about the responsiveness of the marketplace.

In retrospect, some of the reasons for the failure of comprehensive financial reform at the Federal level are apparent. Laws and regulations defining the powers and functions of the various financial intermediaries may be seen as a series of treaties which define boundaries and establish the rules of competition. Changes in the rules of the game or the boundaries of the playing field directly affect a host of interests in complex and unpredictable ways. As a result, any comprehensive change among these interests, however well constructed, is likely to produce winners and losers in relatively large numbers. Moreover, again because the system is complex and our understanding of it imperfect, it is often difficult to predict precisely who will be among the winners and losers. Accordingly, it is neither surprising nor unnatural that various financial interests, faced with concrete legislative packages, would break ranks and fight to protect and advance their own interests.

Although comprehensive financial institution reform has failed miserably in the political arena at the Federal level, technological innovations, developments in the marketplace and action at the State level have tended to take us slowly but surely toward the world that the Hunt Commission envisioned. Mutual savings banks have, of course, taken the lead in this regard with the legendary development of the NOW accounts and with such innovations as telephone transfers. The range of consumer and investment powers which your industry has sought is already available to savings banks and their customers in many of the 17 States in which savings banks compete. In some States, present powers, including interest-paying NOW accounts, actually exceed the goals sought by the Hunt Commission Report. Other institutions are also pushing vigorously at the traditional boundaries of their industries so that distinctions among financial institutions are increasingly blurred. For example, many observers foresee credit unions emerging as potent competitors for household accounts in the very near future, if they have not already.

What I take from all of this is that we at the Federal level and you in the industry should be hard at work developing and supporting proposals which will reinforce, or at least remove the impediments to, progressive developments which are occurring in the marketplace and in the State legislatures even though comprehensive financial reform may be beyond our reach. Here the possibilities are many and varied and I do not today come forward with the LeMaistre plan for financial restructuring or to detail precisely my position on all the possible programs which might surface in the coming months. I will, however, touch on several key points with which any package is likely to deal and which might be of interest to you.

As I indicated earlier, mutual savings banks have moved a long way down the road in the evolution into "full service family banking institutions." In some States, mostly in New England, this evolution is essentially complete. In other States, however, there are important gaps in savings bank powers and restrictions on their operations. In New York, for example, savings bank lending powers are restricted and there are important limitations with respect to demand deposits. It is true that some State laws are uncomfortably binding with respect to commercial banks as well, but the choice provided by the dual banking system means that innovations which genuinely satisfy customer needs are adopted over time.

Recent banking history is replete with examples of this phenomenon. Though many disagreed with the specifics of his decisions, it is clear in retrospect, that Jim Saxon served the banking industry and the public well by allowing national banks to do things repugnant to his colleagues at the FDIC and the Federal Reserve Board. In effect, he helped take banking out of the conservatism that was a holdover from the Depression. Similarly, when Congress has been unable to act in recent months, State legislatures and State regulators have taken the lead pursuing alternative strategies of dealing with financial reform and electronic funds transfer systems. As a result, there exist numerous laboratories whose experience provide insights as to the most nearly optimal approach.

In my judgment, it is simply unfair that mutual savings banks and their customers are denied the considerable benefit of this unique and positive feature of American financial regulation. Thus, I strongly favor immediate adoption of legislation which would provide a Federal chartering option for mutual savings banks.

Although I am aware that political reality may dictate a different result, for my part, I would not restrict the Federal chartering option geographically, nor would I limit it to existing institutions. Also, while I would not oppose designation of the Federal Home Loan Bank Board as Federal chartering authority for mutual savings banks, I do think it appropriate to point out that the FDIC has had more than 40 years of experience in examining and supervising the mutual savings bank industry -- experience which would be most useful to the chartering authority. In any event, I would not like to see the FDIC go out of the business of regulating mutual savings bank altogether. It seems to me highly desirable that at least one Federal regulator be concerned with both commercial banks and thrift institutions in order to assure a balanced perspective.

The financial reform issue likely to receive the most serious attention in the coming weeks is elimination of the prohibition on the payment of interest on transaction balances -- a development which I have long supported. Until recently, debate with respect to this has been somewhat academic. Economists can demonstrate that competition for deposits through the pricing mechanism would result in a more efficient allocation of resources than competition for deposits through indirect means such as the building of branches and provision of free checking, leading to substantial benefits for both institutions and customers in the long run. In addition, scholars have shown that payment of interest on demand deposits was not an important factor in the bank failures of the '30s. Nevertheless, proposals to eliminate the prohibition of payment of interest on demand deposits have not been politically viable.

A number of factors may have changed this equation. The growth and success of the NOW account experiment in New England reflects customer acceptance of the service, encouraging secure and aggressive institutions elsewhere to press for nationwide NOW accounts. Second, interest on demand deposits is almost with us in a variety of other forms, such as credit union share drafts and telephone payments mechanisms. Third, many people, including some Congressmen, perceive this as a consumer issue. Although it may very well be that small depositors, who are currently receiving a cross-subsidy, will suffer if banks price service charges properly, this perception certainly enhances the likelihood of action in this regard.

A new and, perhaps, most important element in this equation is current Federal Reserve concern with attrition from the System. In the past, decline in membership has led the Federal Reserve Board to propose mandatory reserve requirements or mandatory membership. This has proved politically unrealistic. Now faced with the prospect of increasing abandonment by large institutions, the Federal Reserve seems likely to propose payment of interest on reserve balances as a means of reducing the burden of membership. Because this might be viewed as a "give away" of Government revenue to the banks, the Fed may link this proposal with the call for nationwide NOW accounts or the payment of interest on demand deposits.

Taken together, these factors suggest greatly increased likelihood that Congress will provide for the payment of interest on transaction balances in one fashion or another. Nevertheless, I consider it naive to think that the passage of this legislation, even when linked with a Federal Reserve proposal for interest on reserves, faces easy sledding in the Congress. Although there is an air of optimism now, concrete proposals are not yet on the table. When specific legislation is proposed, it may be very difficult for the various interests to work out a compromise sufficiently acceptable to achieve passage.

A third facet of the financial institution reform which will certainly be the subject of attention in Congress later this year is that of the Regulation Q ceilings and the differential. I should state quite frankly that I have long favored elimination of interest rate ceilings as soon as that can be accomplished consistent with the principles of equity and the soundness of the banking system. This, of course, is consistent with my support of the Hunt Commission recommendations and the Financial Institutions Act.

My reasons for this view are several. I believe that the market mechanism and not Government regulators should make the resource allocation and pricing decisions in our economy. While price controls may be necessary on a temporary or standby basis in some cases, I do not favor them as long-run solutions. Almost inevitably, they lead to inefficiencies in the allocation of resources and rigidity in our economy. Interest rate ceilings are a case in point. Certainly, your own experience suggests that they have not protected financial institutions against disintermediation and the squeeze on earnings that occur when interest rates are high. Indeed, there is reason to believe that the ceilings have themselves been a cause of disintermediation. Moreover, notwithstanding the historical linkage of interest rate ceilings and housing goals, the ceilings are an inefficient and disfunctional means of assisting housing. Because the subsidy involved is indirect, real costs to society are hidden. In addition, benefits of the subsidy are not targeted with precision. As a result many recipients of the subsidy do not need it while needed housing goes unbuilt. Finally, and perhaps most importantly, interest rate ceilings constitute a regressive and inequitable tax on small savers.

In short, because I believe that interest rate ceilings are an ineffective and sometimes disruptive form of credit allocation and because I believe that they impose some inequities on small savers, it is my judgment that the proper focus of our attention should be upon how and when and not whether to phase out interest rate ceilings. For this reason, I favor designation of a specific date for their demise. I believe that only in the context of such certainty will bankers and regulators begin to plan seriously, as Saul Klaman suggests that we should -- for a "Q-less" world.

In this area, I should make clear the FDIC's position in one regard. One important defense against possible future interest rate increases and disintermediation that more savings banks are taking advantage of is associated with membership in the Federal Home Loan Bank System. The most recent figures I have seem to indicate that 77 mutual savings banks are members of that System, which reflects a substantial increase. In the past, the FDIC discouraged Federal Home Loan Bank borrowing by insured savings banks. While there may be certain circumstances under which such borrowings may be excessive or inappropriate, the FDIC's policy is in no way to discourage such borrowings. We believe that such borrowings serve as an important source of liquidity for thrift institutions. Moreover, expanded lending by the Federal Home Loan Bank can increasingly play an important role in cushioning the impact of tight financial market conditions on thrift institutions and on home building. It seems to me that the availability of such a facility exemplifies the possibility of developing strategies which more effectively cushion thrifts and the housing markets from interest rate swings. Progress that has been made in developing and marketing new and flexible mortgage instruments represent another productive strategy.

Before concluding, I would like to turn to a matter which should be of great concern to banks and bank regulators -- the problem of devising regulatory systems which involve the least cost and minimum amount of governmental intervention necessary to achieve the desired public purpose. There is a growing consensus among both liberals and conservatives that regulation has gotten out of hand. This consensus is reflected in the regulatory reform movement which includes such strategies as Sunset legislation, zero-based budgeting, regulatory reorganization, and increased reliance on economic incentives to replace detailed regulations. And, of course, President Carter's strong commitment to achieving efficient and effective government provides the leadership force.

In the banking industry, the focus recently has been upon the burdens imposed by various types of consumer regulations such as the Truth-in-Lending Law. I am hopeful that by working in a cooperative spirit with Congress and consumer groups, we can devise strategies that will protect consumer interests and minimize the burden on affected institutions. At the same time, I also believe that we can and should broaden our horizons. There are a variety of regulations, laws, and reporting requirements which ought to be reexamined to determine whether the costs involved are reasonable when compared with the benefits realized. It is my intention, within the limits of our resources at the FDIC, to seek such reexamination.

As I indicated at the outset I do not purport to have all the answers nor do I think that they are to be found in Washington alone. For that reason I actively solicit your criticism, your assistance and support. I hope that we can work together in the coming months to make our system of supervision and regulation more efficient and more effective and that we can devise reasonable solutions to the problems which face us.

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