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REALITY AND MYTH IN PROPOSALS FOR BANKING REVISION

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REALITY AND MYTH IN PROPOSALS FOR BANKING REVISION

In recent years a dialogue has begun within the banking industry on matters of vital importance to its future. A broad re-examination has been launched into the basic structure of the industry and the traditional arrangements for supervision. Proposals have been advanced which range from ideas for relatively minor adjustments all the way to plans for complete and drastic reorganization of the system itself.

Much of the push for change has been based, I suspect, on myth, myth generated from self-interest, or from basic misunderstandings of the system. Many of the proposals are advanced without realistic comprehension of what might be their actual long-range results.

It may be that this nation actually desires a re-orientation of its banking system -- both a re-shaping of the structure and of the supervisory bodies. But before we can determine if proposed changes lead to desirable goals, we must strip away the myths surrounding each one of the proposals, and take a long, hard, and realistic look at what they will actually mean.

Above all we must ask ourselves: Has the banking system as it has evolved actually realized the desired objectives? Has the test of experience disclosed any fundamental weaknesses? Nothing short of complete and fair answers to these questions, and others equally relevant, will do. With the answers to the searching questions at hand, then perhaps we can strip myths away and make realistic judgments on current proposals for change.

Many of the proposals now before the banking industry, Federal and state supervisory bodies, and the Congress, seem to be based on self-interest. To be sure, self-interest can be a healthy posture. There are times, however, when positions formed solely on the basis of self-interest can be too narrowly limited, both in scope and in time. Such positions often seem to concentrate on short-term advantages.

Few would deny that "special pleading" for individual causes explains much of the pressure for change. Likewise, much of the resistance to change comes from a fear of proposed departures from known, safe patterns. Nevertheless, the existing dialogue pro and con on changes in banking is healthy for the nation and for the financial industry -- _if_ that dialogue is realistic and _if_ that dialogue is based on a thorough understanding of what the existing system is and does. It is healthy also if there is a full understanding as to the ultimate results of changes. Such examination can be worthwhile if it re-inforces the best in the system, if it improves the system, and if in the long run it develops a better system.

To cite one example: Branching has become a paramount issue in recent years. You savings bankers located in New York State know what a burning issue it has been for the past ten years -- and continues to be -- despite passage in 1960 of the State Omnibus Banking Act.

On each side the dialogue on branching has been more heated than illuminating. There is one faction which seemingly calls for "change for change's sake." These advocates contend, in effect, that the world cannot be moving forward without changes in existing structures, and they assert that old-fashioned structures are per se outdated. There is a side which contends that "what was good enough for dad is good enough for me" -- a position that cannot be supported by the course of history without much qualification.

At the same time, personal interests dictate the positions of many people on this question. Undoubtedly there are those who oppose changes in branching laws, on any level, because the present system may protect them in an existing monopoly position. Equally it seems true that there are those who seek change as a means for expansion, whether or not that expansion is healthy, and whether or not the means used to achieve expansion may damage drastically the delicate banking fabric in other areas. Active proponents of positions develop and plead their causes, always with the "public interest" as their public reason for action, without adequate disclosure of what their proposals might precipitate in the long run.

As a step in the direction of better understanding it might prove fruitful to examine these two great questions: Why did the American banking system develop as it did, with its great diversity of approach, its delicate interplay of several differing and sometimes conflicting drives and objectives, and its careful balancing of Federal and state controls? And secondly, what are the precise objectives of the present system, and how are these actually achieved?

Answers to these two questions will of necessity be tentative. Indeed, the academic debates engendered by them are almost endless and often acrimonious. But we can touch on some highlights which should enable us to discuss rationally the problems created by this ferment for change. Before we tamper with a system which seems to work well, we must ask ourselves not what we as individuals or as a part of a segment of the financial community might like for our own purposes. We must ask rather what the system was designed to do, whether or not we want to change that system, and what will best fulfill the needs of the system we want, new or old.

To begin with, we must all remember that the American banking system developed far differently than the old European system, which, at the birth of this nation, was the only available model. There were attempts in the early history of the Republic to create a banking system controlled by dominant money interest and tightly responsive to Federal controls. Alexander Hamilton strongly supported such a system, and the first and second Banks of the United States were created to play just such a role.

However, these efforts were ended when President Andrew Jackson defeated efforts to extend the national charter of the second Bank of the United States. Essentially Jackson's action was not a sudden isolated blow, struck by one man, but an expression of national feeling. Part of the reason for the defeat of that bank was the strong and widespread feeling of distrust of moneyed interests. There was a genuine fear that the national economy would be controlled by a few people located on the Eastern Seaboard. Moreover, this emotional bias involved in Jackson's action has survived in one form or another up to the present.

Far more important than the bias against money interests was the underlying philosophy which led to the defeat of the second Bank of the United States. This is the philosophy of local control over financial institutions. In essence, this has provided for a banking system supported by capital assembled from local investors, in which local management dominates, and through which local interests and credit needs are served. Additionally, the necessary public regulation has been established on the local level as far as possible, primarily through state supervision.

During the generation before the Civil War state controls were the only ones. The nation preserved this philosopy of local control, even though it meant an erratic currency mechanism and a volatile and sensitive monetary system. It was not until the Civil War that action was taken to set up a national financial system. It is notable that that system's major goal was not control of banking, but was instead the creation of a new national currency entailing a system of nationally supervised banks to issue that currency. The first act was popularly known as the National Currency Act, clear proof of the emphasis placed on that original legislation. Furthermore, in March of 1865, the Congress imposed a tax on state bank notes, to be effective on July 1, 1866. The purpose of that action was clear: It was designed to drive out state bank issues of currency and replace them with a national currency -- surely a legitimate national policy.

The result, however, was far different, as results all too often are when legislation changes a system in such delicate balance. The state-chartered banking systems were almost driven to the wall. At the beginning of 1865 there were over 1,100 state-chartered banks, compared to 638 national banks. By the beginning of 1867, less than two years after the tax on state bank notes was passed, there were only about 300 state banks and 1,648 national banks. But with a great expansion in deposit banking, state banking systems turned the corner and began to recover. By 1890 there were about 2,800 state banks as against 3,383 national banks, and by 1893 over 4,000 state banks compared with 3,806 national banks. Greater use of deposits as a circulating medium, and, in some states, branching, redressed the balance. We came _that_ close to a completely new system of banking, responsive and responsible to national authorities only -- all because of a major piece of legislation designed to do something far different did not take into account _all_ possible consequences.

Further refinement of the National banking laws, including the famous McFadden Act of 1927, emphasized the national objective of preserving local or state control over financial institutions. Incidentally, it is pertinent to observe that the McFadden Act, far from restricing national bank branching powers, instead permitted national banks to have branches for the first time in their history. Up to that time they had had _no_ branching authority. These actions resulted in formation of the "dual" banking system, which might perhaps be better called the "diverse" banking system.

Additionally, when the Federal Reserve System was created primarily as a means for easing the ebb and flow of credit and to provide a monetary tool for national authorities, every effort was made to decentralize the system. Twelve regional banks were created and given a great deal of autonomy, and mechanisms were established for appointment of Boards which would reflect regional interests.

When the Federal Deposit Insurance Corporation was formed, its structure was carefully tailored to prevent its domination of state systems. Its powers are limited, and its emphasis has always been on close cooperation with, and careful consideration of, state laws and state authorities.

The mutual savings bank fits naturally into this system. The mutuals' purpose, as you all know, is to provide a safe means whereby people may save thrift funds, with assurance of a steady increment of principal, plus that principal's safety. Given the frame work of our system, and how it evolved, it is not surprising that the mutuals now find themselves primarily in the older, Eastern section of the nation. As the nation spread westward, the commercial banking industry gradually began to accept thrift funds. The mutuals no longer had a void into which they could move. This, in your case, was an historic accident -- in timing, at least. But this local orientation plus the timing factor does explain why mutuals were not demanded in these states.

If we ask the question as to whether or not the American banking system works, I think we must all agree that the answer is yes -- and for two basic reasons.

The first, of course, is apparent to all of us. The economy is flourishing; our standard of living is incredibly high, compared to other nations of the world; credit is readily available to millions who could not dream of credit availability in other lands. Walk down any street in the United States and you will find evidences that the banking system is filling its role admirably.

The second area where the American system has proven its worth is, perhaps, less understood, and perhaps, more important. It may be the greatest single contribution of our unique system. This is the distribution, throughout the nation, of credit controls and credit availability. North of the United States, in Canada, financial resources are dominated by the Ottawa-Toronto-Montreal axis. While New York City is the largest single money mart in the world, its position of financial power in the United States is proportionately far less than that of Montreal in Canada.

For every New York there is a San Francisco, for every Boston, a Seattle, for every Philadelphia, a Los Angeles, plus outstanding regional money centers in the Midwest, the Mountain States, the Southwest, and the South. There are, in addition to these, hundreds of regional and local money centers -- and the wealth of these areas flows not to one center, but to dozens of local ones. Controls for allocating resources have provided in this nation a system under which no region need go hungry for funds because they are drained to a major center. True, there are flows of capital -- but the money power is fragmented to the benefit of every region in the country.

Granting this, that the system works, and that one basic reason why it works is this historic element of local control, we should be especially careful when we seek to reweave the fabric of American banking. If there are dislocations and frictions, we should seek to cure them as delicately as possible, but avoid doing anything to upset the whole system. Even peripheral changes in the system may contain elements which are disruptive of and ultimately destructive to the existing system.

We may choose to make such adjustments, but we should do so with a full understanding of what we are doing. As yet, Congress has not made any major revision in the banking system except in times of crisis -- and even then has always worked within the framework of the banking system's local orientation.

Legislation recently proposed by the mutual savings bank industry in the area of Federal chartering may be evaluated both on the grounds advanced by the industry and in terms of the net overall effect of the legislation. Putting aside for the moment the questions of need, and also any judgments I might personally have on these proposals, let me suggest that you carefully consider this measure's key points, not on the narrow basis of self-interest, but on the broad basis of what they will mean to the banking system as a whole. What will these proposals, if enacted, do to the banking structure?

To begin with, in seeking this legislation on the Federal level, the mutual savings bank industry is departing from its historical local orientation. The industry is asking the Federal government to set a pattern for the states, despite the fact that some states have already decided for themselves to operate without mutuals. In seeking a "dual" system which would put them on a par with commercial banks and savings and loan assocations, the mutuals are ignoring the fact that many financial systems are not dual, but operate solely under state charters. The noted exceptions exist not because the industries sought dual systems but because Congress sought to cure pressing problems in the currency and housing areas. In the latter instance, as some of you know, the mutuals were approached by Federal officials and asked to help establish a Federal system, and they declined. It was only then that the system of Federally chartered savings and loan associations was established.

Besides marking a departure from their local orientation, the proposal for Federal chartering contains several provisions which, whatever their merits on other grounds, would lead to substantial revisions of the existing system. In chartering new institutions through the Federal Home Loan Bank Board, the bank-deposit status of the mutuals would be blurred, since the Federal Home Loan Bank Board was and is designed to administer an investment system oriented toward housing. The existing debtor-creditor relationship would also be weakened, if not replaced completely.

Transfer of the insurance function to the Federal Savings and Loan Insurance Corporation would blur even further the mutuals' traditional status. The Federal Deposit Insurance Corporation insures bank deposits; the Federal Savings and Loan Insurance Corporation insures investments. The two concepts are different, and they do lead to differences in attitude, treatment, and law. They are subtle, they are real, and, in my view, they are essential.

The provision that the Federal Home Loan Bank Board may suspend or limit payment of deposits by Board action, as may now be done for savings and loan investment shares, strikes at the deposit orientation of the mutual savings bank industry. This is a fundamental change.

The broadened lending powers contemplated by the proposal go far beyond the concept of pools of savings deposits invested for safety and a fair return. In making such investments, the mutuals might be exposing themselves to risks quite appropriate for stock institutions, but perhaps out of place for mutual institutions.

The almost complete elimination of state controls over branching represents a sharp departure from the existing philosophy. The net effect will be to force the states to liberalize all financial branching statutes to fit the most liberal allowed any form of financial system, except life insurance companies.

Taken together, this series of actions might well lead to a complete relaxation of state powers, and a snowballing increment of Federal controls. The net result probably would be a shift of emphasis to a system more akin to systems in other nations, with strong Federal or National patterns of supervision and regulation, and a concentration of the private initiative in a few money centers.

Additionally, I suspect, federal chartering would increase the competition the mutual savings banks will face directly. Though this bill is designed primarily to assist the mutual industry to enter other areas, it can also intensify competition among existing institutions. The bill would permit other established and competing financial institutions -- savings and loan associations, to be specific -- to convert to Federal mutual savings bank charters, and many in the savings and loan industry can be expected to convert to secure the far broader powers allowed by the bill. In addition, newly chartered Federal mutuals can be opened in direct competition with existing mutual institutions, without any state controls and with the broadest possible investment and branching powers. The result, most likely, would be an immediate and sharp competitive challenge within your own areas of operation, by institutions on a parity with you -- provided you converted to a Federal charter. If you kept your state-chartered status, you would be at a substantial competitive disadvantage.

Perhaps the time has come to re-examine these proposals, not only in the light of what the industry deems to be its legitimate objectives, itself a proper approach, but also in the light of what these proposals will do to the basic banking structure of the nation. Perhaps the time has come to strip away any myths, and to examine these proposals in the light of reality.

I would urge each of you individually to consider these points. Do not delegate your basic responsibilities as members of your industry and as citizens of this country. Instead, yourselves analyse the impact of all such proposals, reach your own conclusions, and make them clear to others.

If after such an examination these measures still seem desirable, present them to Congress and to the nation as a whole, realistically and honestly, for full and open debate. And in so doing, be prepared to answer one question: Are you prepared to show that changes in this nation's basic banking structure will improve it? This is the key question you must answer, and the fundamental question that must be weighed by the Congress.