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Remarks by K. A. Randall, Chairman,
Federal Deposit Insurance Corporation,
Before the Annual Convention of the American Institute of Banking
at San Diego, California, on June 3, 1966

Last month, the House Banking and Currency Committee opened hearings on two bills designed to impose restrictions on commercial bank time deposits--one prohibits the issuance of certificates of deposit and other bank obligations and the other bars banks from accepting time deposits in amounts less than $15,000. In the course of the hearings, additional proposals were advanced to place a uniform interest rate on all types of time and savings deposits and borrowings of banks and to permit higher rate ceilings on large deposits.

These proposals have been generated by the recent intensification of competition among financial institutions for savings, coupled with continued high levels of economic activity. It is not my intention today, however, to comment directly on these specific proposals. I want to concentrate instead of some of the major issues and problems that have been illuminated by the proposed legislation and the current situation in the financial markets. These are the issues and problems that will be with us in the years to come--in one form or another. An understanding of their nature and their implications is therefore essential.

I am particularly pleased to be able to speak to an audience such as this today because you are the ones who, in the future, will have to face and solve problems similar to those posed by the current vigorous competition for savings. Most of the managerial talent for the banking industry will be drawn from your ranks. Your ability and resourcefulness in coping with the problems of the future will be a crucial factor in preserving the strength and viability of our financial institutions.

The current economic situation is characterized by high and still rising levels of economic activity, close to full employment of our plant and manpower resources, and strong upward pressures on interest rates and on the demand for credit. Our international commitments at the same time inject an element of uncertainty into the economic outlook. The financial markets reflect the interaction of all these forces, which may be intensified this month by record corporate tax payments due at mid-month and by expectations of the savings and loan industry that withdrawals from share accounts after the dividend payment period at the end of the month may exceed the inflow of new savings.

Although pressures in the financial markets may be severe this month, generally speaking the major segments of the financial community--the commercial banks, the savings banks, and the savings and loan associations--are strong and well able to withstand these short-run pressures. Furthermore, you may be confident that the various supervisory authorities are also prepared to provide whatever assistance that may be necessary with every means at their disposal.

The present conjuncture of circumstances, nevertheless, provides several good illustrations of problems we may expect in the future. One of the major factors in the current situation is the strong competition among financial institutions for funds to meet the demand for business financing, for consumer credit, and for mortgage financing. This competition is taking place against a relative shrinkage in the volume of new savings. In the first quarter of this year, for example, saving as a percent of disposable personal income totaled only 5.0 percent compared to 5.6 percent in the last quarter of 1965. At the same time, a larger proportion of the savings is being channeled directly from the saver to the borrower through the capital markets rather than through financial intermediaries.

Since the mid-1950's, commercial banks have been filling an increasing proportion of the nation's credit requirements, after having lagged behind other savings institutions in the immediate postwar period. However, so far this year, commercial banks have met only about one-fourth of the nation's financing needs compared to 40 percent in 1965. Indeed, the major savings insitutions have had to compete for a less rapidly growing savings pie. Adapting to a slower rate of savings inflow is not an easy task, particularly if operations have been geared to a large continuing inflow.

The adjustment process, however, has been eased by a concomitant slowdown in demand in certain sectors of the economy and by the restraining effects of a tighter monetary policy. This is an opportunity to strengthen portfolios, to reassess short-and long-run factors, and to match activity more closely to supply and demand factors currently operative in the market. For financial institutions such as savings banks and savings and loan associations the adjustment process is slow because of the long-term nature of their investments. Liquidity needs and commitment policies may have to be reevaluated in light of the future prospects for housing and construction and for savings.

This reevaluation process is equally beneficial for our commercial lending institutions. The role of the large negotiable time certificate of deposit--and, more recently, the related small-denomination savings instruments--might be usefully reexamined by every bank to determine whether undue dependence is being placed on these instruments for deposit growth and whether liquidity requirements might need to be strengthened for these deposits. The competition for these interest-sensitive funds, moreover, has become so intense that it might be questioned whether there is any net gain to the bank in deposit volume or only higher interest costs. The banking system as a whole may be only stimulating more frequent shifting of funds or an upward ratcheting of the rate structure rather than attracting additional savings.

Higher interest costs in turn have placed pressure on bank profit margins. Over the longer run, profitability is a major determinant of the types of activities in which a bank engages. Attention may be focussed on growth in the very short-run but only at a bank's peril can it ignore profit considerations over the long run.

Similar considerations are relevant in a bank's lending operations. The present strong upward pressures on the nation's resources call for restraint on the part of both lenders and borrowers.

The financial sector now has reached an especially significant milepost--from this point forward a high degree of statesmanship, responsibility, imagination and restraint is required. We have reached the point where adjustments must be made to circumstances that have evolved gradually--over the whole postwar period in some cases and during the present economic expansion in others. Operations cannot be blindly predicated on continuation of the previous high rates of growth in savings inflow or in the demands for credit.

All of our major financial institutions have responded well to the challenge of directing the nation's savings into productive use and of meeting the nation's credit needs. But as savings flows decline or as particular credit needs are satisfied, it is equally the responsibility of our banks and savings institutions to adjust to the changed situation. Adjustment to a slower growth rate or to shifting demands in the economy is a much more difficult assignment than adjustment to rapid expansion, but it is an assignment whose successful completion is essential to the fundamental health of our financial system.

The past six months have emphasized another facet of our financial mechanism--the essential interrelationship of all our financial markets. The increase in the Federal Reserve discount rate and in the interest rate ceilings last December was designed to impose a measure of monetary restraint on the burgeoning economy and at the same time give banks somewhat greater flexibility in attracting deposits to accommodate strong loan demands. By raising the ceiling to $5\frac{1}{2}$ percent, however, a $1\frac{1}{2}$ percent differential was opened up between the rate paid on passbook savings accounts and the rate on other time deposits. Although rates were not expected to move to the ceiling, they in fact rose rapidly as banks competed for funds. The size of the differential provided a very strong inducement for banks to develop new instruments to attract funds.

Banks have responded since December to the higher permissible rate structure with innovations in the types of deposit facilities offered to the saver, such as savings or investment certificates and savings bonds. Both the Federal Reserve and the FDIC are currently conducting surveys of banks under their supervision to find out more about these new savings instruments and how savers have reacted to them. From these surveys we hope to obtain a better insight into bank responses to changes in interest rate ceilings.

A second result of the December increase was an acceleration in the movement of funds between different types of deposits, between banks, and also between different types of financial institutions. The success of banks in attracting a larger proportion of new savings has had a dampening effect on other savings institutions. To a yet undetermined extent, moreover, banks may have drawn interest-sensitive funds out of these financial intermediaries--although other competitive investment outlets doubtless contributed to the slower growth in savings at these nonbank financial institutions. Within the banking system, in addition, larger banks found themselves competing against smaller banks.

These interactions resulting from action in one sector illustrate the close interrelationship of financial institutions in today's markets and demonstrate the difficulties of foretelling with accuracy financial responses in a financial market as complex as ours. The practically impossible task of separating and isolating one sector of the financial markets from another suggests strongly that, to the extent that regulation and supervision are needed, they should be applicable to all sectors of the market.

The ability of banks to compete successfully today against specialized thrift institutions in attributable largely to the fact that banks are multi-purpose institutions. Through their broader investment opportunities and their ability to provide a wise variety of financial services, banks are in a relatively strong position to attract customers. The advantage that banks hold over other financial intermediaries thus cannot be eliminated simply by rate equality. This conclusion leads in turn to the very interesting question of the future of special-purpose institutions.

The development of the future could very well be the evolution of single-purpose institutions toward a multi-purpose operation as financial markets become increasingly integrated. The constantly growing and diversified credit needs of our economy may push us steadily toward this concept of "one-stop" banking. From a financial system with savings institutions at one end of the spectrum and commercial banks at the other, we may see a "merging toward the center" as our financial institutions adjust to changing circumstances. In the process we may also achieve a more efficient allocation of our financial resources without the sacrifice of private initiative and enterprise.

As recent experience amply demonstrates, our financial structure is constantly changing and adapting. New patterns in the flow of savings have emerged and new techniques are in use. Problems have arisen as a consequence of these recent developments. It is the responsibility, however, of the supervisory authorities to facilitate the necessary adjustments during transition periods with as little friction and disturbance to the market as possible. Whatever actions are taken--whether affecting rates, instruments, or even institutions--should be taken with caution because of possible unforeseen and unfortunate repercussions. The geographical diversity of our nation heightens this possibility. Serious imbalances or prolongation of the adjustment period also could result from an incorrect course of action. The impact of any particular action, moreover, could vary with the circumstances in which it is undertaken. Consequently, the supervisory authorities must be accorded maximum flexibility in this area to tailor their actions to the particular situation. Packaged prescriptions might well be unsuitable--and also highly inflexible.

The lact of a neatly packaged solution should not be equated with inability to find a solution. In many cases, an approach more easily adapted to particular circumstances or selective in its impact may be preferable.

Although our financial institutions are generally strong, there are always a few trouble spots. It is for this reason that the Corporation is currently strongly supporting the proposed legislation for cease-and-desist authority against unsafe and unsound practices of banks and savings and loan associations and for authority to remove directors or officers of institutions whose actions may weaken the position of the institution, its depositors, or shareholders. The bill now pending in Congress would reinforce and widen the range of existing remedies for correcting unlawful, unsound, or irregular practices that are unfortunately still found from time to time. It permits the supervisory authorities to take action quickly and effectively short of more drastic action such as a takeover or termination of deposit insurance, which are the alternatives now available to us. The bill also provides protection of the rights of any institution, its officers, directors, and others involved.

In closing, I would like to summarize briefly what we are learning from the dialogue in the financial community today. First, adaptability and flexibility of all our financial institutions to changing circumstances--whether on the supply side or on the demand side--are essential for the continued strength of our financial system. Secondly, any action affecting one sector of our financial markets has an impact on all other sectors; our financial markets cannot be compartmentalized. Thirdly, the complex ties between all sectors of the financial markets argue for across-the-board regulation, if regulation is needed. Fourthly, the advantage that a multi-purpose financial institution has over a single-purpose institution tends to lead us to the conclusion that a greater diversification of powers within an institution may be the development of the future. Finally, the supervisory authorities must remain alert to these developments and be prepared to aid the adjustment process. It is an important responsibility that we do not take lightly.

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