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Remarks by

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Washington, D.C.

before the

Annual Convention of the

DISTRICT OF COLUMBIA BANKERS ASSOCIATION

in

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Although we are members of the same community--in both a physical and an economic sense, I all too infrequently find an opportunity to talk to you at length about subjects of mutual concern and interest. It is therefore with great pleasure that I meet with you today.

We are many miles from Washington--but the current dialogue among the members of the financial community in the Nations's capital and all across the nation cannot--and should not--be left behind. Over the past month, the House Banking and Currency Committee has been conducting hearings on several proposals to restrict commercial bank time deposits in one form or another. The proposals have been advanced by their sponsors in an effort to ease or possibly even check the strong competitive pressures in the savings market.

I do not intend, however, to focus my attention directly on these various proposals. Rather, I would like to comment briefly on some of the principal factors that have been responsible for the current situation in the financial sector, on their implications for the future, and on what I think are the relevant factors and the alternative courses of action worthy of careful study.

An air of urgency has been imparted to the search for solutions because of expectations that market pressures will become more intense in the next several weeks as sizable corporate tax payments become due and the midyear dividend payment period for savings banks and for savings and loan institutions nears--with its threat of enlarged outflows attracted by alternative investment opportunities.

Let me first inject a note of caution against the hasty adoption

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of inappropriate solutions. Such solutions could produce wholly unforeseen results and create additional problems. Our financial institutions are in general strong and vigorous, and the supervisory authorities stand ready through every means at their disposal to provide assistance where needed and when needed. I am confident that the financial community can weather the seasonal strains immediately ahead.

In our preoccupation with immediate prospects, we tend to lose sight of the broader issues and problems raised by the current competition for savings. It is these issues and problems to which I would like to turn now.

The current economic situation is the net result of a combination of factors operating over the postwar period. In the first decade and a half after the end of World War II, rivalry between institutions in various sectors of the financial community was quite moderate because nonbank thrift institutions were amply supplied with new savings to finance the housing boom. At that time, commercial banks held a substantial portion of their total resources in the form of cash and Federal Government securities. A large part of their efforts were devoted to the task of building up their loan portfolios, thereby improving earnings. But the situation began to change in the early part of this decade as a result of several significant developments.

In the first place, the expansion in our domestic economy since 1961 has placed increasing pressure on our plant and manpower resources. Some relief has been afforded by a slowing down in the demand for final product in certain sectors of the economy--notably housing, but this in

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turn, however, has had an adverse effect on the specialized thrift institutions. Secondly, the persistence of sizable deficits in our international balance of payments has led to a significant modification of previous interest rate patterns, with an impact on the domestic sectors of the economy. Thirdly, the growth in commercial bank activity and more aggressive lending policies--facilitated by the lifting of interest rate ceilings on time and savings deposits in 1961 and the introduction of the large, negotiable CD--resulted in highly effective competition by banks vis-a-vis single-purpose financial institutions such as savings banks and savings and loan associations. This competition did not begin to pinch until recently, however, when strong market pressures began to force rationing of scarce financial resources among competing uses. The rationing process has been reinforced in turn by a greater degree of credit restraint by the monetary authorities. Finally, a factor that has an important but indeterminate bearing on the current situation is the uncertainty associated with our international commitments.

These are the major forces that have shaped the current financial scene. They are the forces that we must learn to live with, to adapt to, and to use for our mutual benefit. The role of the supervisory authorities is to promote adjustments suited to changing circumstances. Their actions during the difficult transition period should be designed to minimize friction and disturbance to financial markets. To accomplish this, the supervisory authorities need powers that may be adapted to the circumstances. In all cases, the alternative selected must be selected with full recognition of the basic factors involved and in harmony with a constantly evolving and necessarily changing financial structure.

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The supervisory authorities essentially carry out a supportive role; the primary responsibility for the adjustment remains with the individual financial institution. Each commercial bank, each savings bank, and each savings and loan association must, in the final analysis, rely on its own resources--both human and financial--to preserve its vigor and its vitality. Nevertheless, both the supervisory authorities and the individual financial instituion must recognize that their actions are subject to the limitations and realities of the economic environment in which they operate.

One fact of particular importance is that financial markets are becoming increasingly complex and increasingly interdependent. No longer are financial flows confined to one sector of the market. As a consequence, constraints in one part of the market can be expected to influence developments in another part of the market--in a manner that could be wholly unexpected and even undesirable. Unrestrained actions in one sector will tend to spill over into other sectors--and perhaps even produce diametrically opposite results from what was originally intended. A timely illustration might be provided by the current competition among banks themselves--or between banks and nonbank financial intermediaries--for savings. It is possible that the competition has succeeded only in stimulating a more frequent shifting of funds--in and out of financial institutions or in and out of the money and capital markets--or an upward ratcheting of interest rates rather than any net gain in deposits or in the efficient employment of the nation's financial resources.

Because of the growing interrelationship between financial markets, I think serious consideration should be given to the extension

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of regulation--where regulation is needed--to all related financial institutions so as to minimize adverse repercussions and disruptive shifting of funds. "Across-the-board" regulation and supervision--when used--would have the virtues of equity, nonsegmentation of essentially unified financial markets, and minimization of unpredictable and noneconomic responses.

The need for adaptability and adjustment to change is one of the imperatives in coping with the situation today. To illustrate, a change may occur in the demand for a product--such as housing, which has been relatively sluggish for the past year or so--or in the demand for financial intermediation services. More of our savings so far this year, for example, is moving directly from the saver to the borrower; commercial banks supplied only about one-fourth of the nations's credit needs in the first three months of this year, compared to 40 percent in all of 1965. The savings and loan associations have been harder hit by the slowdown in the demand for mortgage financing than banks, while both have had to vie more aggressively for a smaller volume of new savings. It could also be a change in the rate of change, which could cause as much difficulty.

The adjustment process itself necessitates a searching reevaluation and reexamination of time-honored practices and policies. It is much more difficult for instance, to adjust to a slower rate of growth than to a strong expansion. Major changes in institutional portfolios--in the form of increased liquidity to guard against the greater volatility of interest-sensitive funds or changes in lending policies or in operational emphasis are involved. In this respect, the specialized thrift institutions are less favorably situated than commercial banks. The

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portfolios of the single-purpose financial institutions tend to turn over more slowly and their investment alternatives are more limited. The broad range of investment opportunities available to banks and the variety of financial services offered, on the other hand, give banks a competitive advantage over the single-purpose institution that is not completely eliminated with rate equality.

For this reason the future could well see the evolution of the single-purpose institution "toward the center"--to a form of multi-purpose operation. "One-stop banking" may be the development of the future--encouraged by the steadily growing integration of financial markets. The result could be more efficient and beneficial use of the nation's financial resources.

Although banks and other financial institutions must necessarily assume a major share of the responsibility in this evolutionary process, the supervisory authorities must nevertheless be equipped to carry out their share of the responsibility--to support the financial markets during transition periods, to see them through seasonal and unseasonal short-run periods of stress, and to help in adjustments to fundamental changes. A compact package designed to assist the authorities in this task and to provide them with techniques to fit any situation might sound intriguing. But it would be a highly unrealistic package because any given set of prescriptions is liable to prove inflexible, unsuited to every occasion, often indiscriminate in its impact where selectivity is needed, or just ill-adapted to a particular set of circumstances.

Recent experience has demonstrated quite clearly, I think, that any action in the financial sector--whether affecting rates, instruments,

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or institutions--can have unforeseen and unfortunate repercussions unless due caution is exercised. As a result, the adjustment period can be prolonged or the original situation aggravated. New techniques might be developed to circumvent restrictive action, and financial flows could open up new channels. This listing should give you some idea of the problems that can be posed by inflexibility in supervisory powers.

In conclusion, what is needed in this rapidly changing and challenging world is flexibility--maximum flexibility to handle a situation in the manner best suited to the particular situation. Maximum flexibility, however, should not be confused with maximum authority. The supervisory authorities do not need--or want--all-embracive powers over financial institutions. All we ask for is the freedom to utilize in a flexible manner those powers that are essential to assist us in helping you.

In the long run, overly restrictive covenants will hamper your operations more than protect, while maximum flexibility for the supervisory authorities will enhance your freedom rather than detract from it. A fine balance between flexibility and regulation will contribute most to the maintenance of a strong financial system of benefit to all.

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The attached remarks of K. A. Randall, Chairman of the Federal Deposit Insurance Corporation were presented by William W. Sherrill, Director, before the Annual Convention of the West Virginia Bankers Association at White Sulphur Springs, West Virginia, on July 22, 1966.

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