Remarks of

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The Federal deposit insurance system was authorized by Congress in 1933 during the Great Depression to protect depositors in banks and to help restore public confidence in our banking system. At the outset, the Federal Deposit Insurance Corporation was chiefly concerned with the rescue of failed or failing banks and resumption of normal banking activities. The sharp reduction of bank failures in the years following the Corporation's establishment in 1934 clearly evidences the success of the Corporation's efforts to achieve its major objective. Bank failures dropped from 4,000 bank closings in 1933 to an average of 54 per year in the 1934-42 period. Moreover, the Corporation's activities were--and still are--considered an important contribution to economic stability.

By the end of World War II, when the Employment Act was placed on the statute books, the Corporation's role was viewed narrowly as one of providing support for the banking system. Congressional hearings in 1949 conducted by the Joint Committee on the Economic Report included testimony by the Chairman of the Corporation that the purposes of deposit insurance were:

> "To protect small depositors, to maintain the confidence of depositors in the banks, to raise standards of bank management and increase the soundness of the banking system, and to aid in protecting the circulating medium. Accomplishment of these purposes would contribute to economic and financial stability and thus serve to further the purposes of the Employment Act."

The Chairman also declared that since the Corporation was discharging these duties in accordance with its statutory authority it was "making a maximum contribution to furthering the purposes of the Employment Act . . . ."

The Corporation's purposes have not changed in essential respects from those described some $17\frac{1}{2}$ years ago, but the environment in which the Corporation is operating today is significantly different--and, as a consequence, its orientation also has changed. The difference can be ascribed in large part to the impact of the Employment Act of 1946, which set forth the objectives of maximum employment, production, and purchasing power.

The Employment Act was significant primarily because it symbolized the nation's acceptance for the first time of the role that the Federal Government and its agencies could play in attaining the Act's objectives. Because the goals were phrased in general terms, moreover, they have not become outmoded with the years but instead have been broadened to include the objectives of price stability and steady growth, as well as balance in the nation's international accounts. As a symbol of a major shift in economic thinking, therefore, passage of the Employment Act of 1946 marked a strategic turning point in our history.

The recent steady progress toward attainment of the goals of the Employment Act has broadened our sphere of activities and responsibility. The changed environment has necessitated adoption of new ways of viewing problems and consideration of new ways of solving them. The change is one of significant import for banks and other financial institutions as well as for bank supervisors.

The recent relative stability of the economy at high levels of employment and production, such as we have today, depends on the maintenance of full employment levels for its perpetuation. Under these circumstances, there is less margin for error in bank decisions and a greater need for flexibility in bank policies and practices in order to adapt to an economy operating close to capacity levels. Even if the problems currently encountered by the banking agencies are basically unchanged in nature, they are greater in magnitude, if not also in complexity, with the expansion of the economy and growth in the size of financial institutions. The responses of a bank supervisory agency such as the Federal Deposit Insurance Corporation to these recent changes in the banking environment therefore must be more imaginative, more adaptable, and more precisely tailored to meet the particular situation and to anticipate future problems than ever before.

The steady postwar expansion in consumer instalment credit and the recent spurt of activity in bank credit card plans provide a good example of a development that bank supervisory agencies such as the Federal Deposit Insurance Corporation face in a constantly changing environment. As the aims of the Employment Act approached realization, consumers became less reluctant to assume debt and commit future income for current consumption. They developed greater confidence in a continuing rise in income and employment and in the security of both jobs and income. Lenders likewise were more willing to extend credit to consumers as fluctuations in economic activity and in personal income were dampened. As banks became active in consumer credit financing, their policies and practices in this area as well as overall trends in consumer credit were increasingly of interest to bank supervisors.

Over the past 20 years, the dollar volume of consumer instalment credit outstanding has risen spectacularly from $4 billion at the end of 1946 to almost $75 billion at the present time. The expansion occurred at a rapid yet fairly consistent rate, with only a few exceptions.

Commercial banks have been a prime factor in the growth of consumer financing. Your share of the consumer credit market has been increasing and now accounts for about half of consumer instalment credit outstanding. Moreover, your activities in this field are more diversified than others extending credit to consumers and include direct lending to individuals for various purposes, the purchase of instalment paper from retailers, and the financing of finance companies' and retailers' receivables. Commercial banks were responsible for more than 55 percent of the automobile credit outstanding at the end of January 1967, about one-fourth of the non-auto credit, one-third of the personal loans, and 70 percent of the repair and modernization loans. Small banks have been particularly active in auto financing; their auto loans have been rising much faster than similar loans at the medium-sized and large banks.

Expansion in the volume of consumer instalment credit has contributed importantly to economic growth in this country. This innovation in the financing of consumer goods purchases has facilitated substantial improvements in the standard of living for most of our population, especially the lower income groups and young married couples just starting a household. Furthermore, it has been of great advantage to the smaller retailer and manufacturer. Of broad significance is the greater flexibility in timing accorded the consumer in the purchase of "big-ticket" items, which in turn helps to dampen fluctuations in consumer spending and likewise in consumer durable goods production.

The postwar upsurge in the dollar volume of consumer credit can be attributed to a number of factors, aside from the technical change in payments methods. Evidence suggests, for example, that consumers are upgrading their purchases--buying better quality goods at higher prices. New demands have emerged for high-priced goods such as mobile homes and boats and for services such as travel and educational expenses. In addition, the financing of services on an instalment basis has more than doubled in the last five years--a growth rate greater than for any other type of consumer instalment credit. The increasingly widespread ownership of automobiles--the hallmark of an affluent society--has further added to the consumer credit totals. Possibly most important have been the increased willingness of consumers in the postwar period to incur debt and the proliferation of institutional facilities to extend consumer credit.

Since late 1965, the rate of increase in consumer instalment credit has slackened to some extent. There has been some weakening in the demand for consumer credit as well as some diminution in the availability of loanable funds. The generally higher cost of money, however, was not fully reflected in consumer credit costs and therefore had only a minimal effect on the demand for consumer credit. Much of the current weakness in the demand for such credit may be ascribed to the slower pace of auto sales.

The recent behavior of consumer instalment lending has prompted questions about its impact on consumer spending in particular and on economic activity in general. Once again, questions have been posed with regard to the aggregate volume of consumer instalment credit and its sustainability. To be sure, the tapering off in the demand for automobiles is not wholly unexpected after three consecutive record sales years. Viewed in perspective, the fact that consumer instalment credit extensions and therefore consumer spending were less buoyant was not a wholly adverse development since our economy had been operating for a prolonged period close to capacity levels.

Looking at the level of consumer instalment credit over a longer period, there is little to indicate that the present levels of consumer debt are excessive or that the economy is approaching a ceiling for this type of credit. The ratio of repayments on consumer credit to disposable income rose to a postwar high of 14.5 percent in the first quarter of 1966 but subsequently eased to 14.3 percent by the final quarter of last year. However, the decline in this ratio since early 1966 can hardly be viewed as evidence of credit saturation.

No doubt a number of consumers have incurred progressively heavier debt burdens over the years. But there has also been a significant increase in the number of consumers making commitments for the first time. For example, the number of households under 25 years of age has been steadily rising. This is the age group where the need for consumer goods typically exceeds ability to pay out of current income and where there is the greatest use of instalment financing. In addition, changes in forms of payment, such as the substitution of instalment credit for the more traditional forms of financing, were also a factor.

Within the field of consumer credit, a relatively new development has lately been attracting much of the attention of banks and bank supervisory agencies--bank credit cards. A number of banks in the Midwest are currently engaged, for example, in introducing credit card plans to the region. In addition, there are other banks in the area working on a cooperative basis with others in the development of nationwide interchangeable credit card systems.

The credit card plans in effect have a large number of variants, which I will not take the time to describe. But they can be roughly classified into bank credit card plans, check-credit plans, and what might be termed the overdraft-travelers' check plan. All these plans differ as to details, organization, and geographical coverage, but they all generally feature granting of a line of revolving credit to the consumer. The bank credit card plans, in addition, involve financing of the merchant retailer. The plans are local, regional, or national in coverage.

Bank credit cards, however, are not a brand-new development. The first bank credit card plan was introduced in 1951. The subsequent history of bank credit cards is checkered and their development proceeded in "fits and starts," with brief periods of renewed interest in 1953 and again in 1959. Many of the banks that entered the field in those years dropped out because of unfavorable experiences. High start-up costs for equipment, personnel, and advertising; inability to sustain losses in the initial years of operation; and inadequate advance planning also took their toll.

In 1965, however, bank interest revived, and the number of banks adopting plans grew rapidly. Improved profit prospects--due in part at least to the cost-reducing potentialities of a computerized operation--have probably been the major factor in the resumption of bank activity in this area. At the present time, it is estimated that there are around 1,000 banks with some type of credit card arrangement; about three-fourths of this total is concentrated in the four-state region of Illinois, Michigan, Indiana, and Wisconsin.

Of greater significance than the details of individual plans are the implications that bank credit cards and related plans hold for the economy as a whole, for the financial system, and for the payments mechanism. Bank credit cards are also of obvious concern to the supervisors of financial institutions, the consumer, the retailers, and, of course, the banks themselves--whether or not they establish or participate in a credit card plan.

The bank credit card has been hailed as the forerunner of the checkless and cashless society of the future. Whether the present plans will actually evolve in that direction remains to be seen. The payments mechanism of the future could develop an entirely different orientation. Since that possibility does not seem imminent, we might more profitably concern ourselves today with some of the immediate problems and practical ramifications that confront the bank supervisory authorities in the spread of bank credit card plans. I am not going to attempt to offer solutions but only pose questions. The answers will require careful thought and more experience.

Bank credit cards can have an impact, for example, on the proportion of consumer spending based on credit and on current patterns of consumer spending and saving. More purchases might be made on credit and more of current income spent. As a consequence, personal savings patterns could undergo some basic changes, and the flow of individual savings to financial intermediaries could be sharply curtailed. Bank financing of business might be adversely affected if the traditional avenues for channeling funds from individuals to business through the intermediation of banks are disrupted. Monetary policy actions, moreover, would have to take into account the possibility of offsetting actions by credit card holders to credit restraint.

The use of bank credit cards also has broad implications for an individual bank's competitive situation vis-a-vis other banks and those nonbank financial institutions offering consumer credit facilities. Success of bank credit cards and related plans could divert an increasing share of the consumer credit business to banks and thus strengthen the competitive position of banks in this expanding field. On the other hand, the profit potentialities in the credit card area have already encouraged nonbank credit card plans to establish joint ventures with banks, while some of the large, diversified businesses with substantial retail and financing activities may also decide to enter the credit card business themselves.

Further development of the credit card business could result in significant shifts in the composition of bank loan portfolios, with consumer credit increasing in importance. The interchangeable card systems that utilize correspondent banking relationships--as here in the Midwest--could also have important implications for bank structure. These possibilities indicate just a few of the broad industry issues and the financial ramifications posed by credit card plans for bank supervisors.

The operations of an individual bank may be significantly affected by its participation or nonparticipation in a bank credit card or related plan. For a bank contemplating participation in an existing plan or establishment of its own credit card plan, the decision should be based only on a careful consideration and assessment of all factors involved. Costs must be weighed against the benefits that the bank expects to realize from introduction of a credit card plan.

Bank management must make a number of major operating and policy decisions. In the first place, are the bank's customers--both actual and prospective--receptive to the introduction of bank credit cards and in need of additional credit facilities of this type? Past experience indicates that a large volume of transactions is needed to support a profitable operation. If pressures to achieve a volume operation are too great, there is some danger of a deterioration in credit quality.

Secondly, is a credit card plan essential to the bank from a competitive viewpoint alone? The larger the number of competitors engaging in the bank credit card business, the smaller is the competitive advantage of any single institution. Nevertheless, promotion of this type of activity could divert substantial credit business from large retailing firms that currently maintain their own credit departments. Such an outcome would be somewhat similar to the situation that developed when banks successfully introduced the large, negotiable certificate of deposit and attracted a sizeable volume of corporate funds away from the money market. Additional business could be developed also from a shifting of a larger proportion of a small retailer's sales to a credit basis. One by-product would also be the opening-up of new sources of bank income and increased potential markets for sale of other bank services.

Competitive pressures "to keep up with the times" could overwhelm a smaller bank especially and lead to its involvement in a credit card plan before it fully realized the extent of the costs and burdens assumed. Therefore, it is most important that a detailed review of the pros and cons of bank credit cards be undertaken before a decision is made. Will the bank, for instance, be able to bear the heavy start-up costs in terms of equipment, personnel, and advertising needed to launch such a plan? Is the institution able to sustain losses for several years until the break-even point is reached? On the other hand, franchises should not be purchased merely to forestall competition.

Not only must these initial decisions be made, but bank management must remain aware of many other important implications of bank credit card plans for bank operations. A bank, for instance, might be able to estimate fairly accurately the maximum potential demand for credit under its credit card plan, but the use of these credit facilities could vary sharply from month to month as well as seasonally. Consequently, a bank's liquidity requirements might have to be modified to accommodate possible new demands on its liquidity position. The intensity of usage could also vary inversely with changes in monetary policy as more holders use their credit lines in a period of credit restraint, thus adding to pressures on a bank. Because the profitability of a bank credit card operation depends, moreover, only on the spread between costs and income without the added mark-up which is available to the retailer, a bank has a narrower margin in which to absorb credit losses. High credit standards are therefore even more important for banks than for retailers offering consumer credit.

Bank credit cards and related plans hold both promise and pitfalls for banks. Greater stability of consumer spending through the spreading out of consumer purchases over time has undoubtedly contributed to economic growth and to a more dependable yet expanding demand for bank credit. Although there are risks in moving into the credit card field--as in any new venture, the opening of this market to banks appears to offer increased opportunities to serve the convenience and needs of the public. It offers new challenges as well as new problems for banks and bank supervisory agencies.

No matter what the problem or the challenge--whether bank credit cards, consumer credit in general, or some other development in the financial sector--the imperatives of the new environment necessitate a continuous re-examination of old policies and practices by banks and bank supervisors. The banking industry as well as the supervisory authorities must be willing to consider new policies and approaches and to abandon or modify old policies and practices when deficiencies are discovered to exist. Only through such a continuous selecting and sorting process can worthwhile financial innovations be tested for their value in the further development of our financial system.

The responsibility to initiate innovations does not rest with bank supervisors--but with bank management. As bank supervisors we do not want to inhibit innovation, but it is also our clear duty to indicate to banks the difficulties as well as the opportunities as they enter new fields of activity.