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Remarks of

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A number of issues of current significance for banks are commanding public attention. Consideration of these issues has taken place against the background of the present-day banking environment--an environment dominated by a complicated legal structure governing banking operations. I am often reminded of this complexity in the course of my travels around the United States to speak before the state banking associations. Represented at these conferences are federally-chartered and state-chartered banks brought together by common interests. The quality and caliber of bank management at these meetings are consistently high. Nevertheless, it is possible to observe even slight differences in approach and orientation to various issues, depending on the banking laws governing banking in each state.

There are fifty different state jurisdictions in addition to the Federal banking agencies. To say that we have a dual banking system is thus an oversimplification of the facts. What we have really is a diverse banking system with multiple legal controls. Under these circumstances, we can all be justifiably proud of the effectiveness of the system in meeting the financial needs of a rapidly expanding economy.

The existence side by side of Federal and state bank chartering authorities has been the distinguishing feature of our banking structure since the enactment of Federal legislation in wartime over a century ago to permit the incorporation of national banks. Accordingly, the term "dual banking system" should therefore be viewed principally as descriptive of the Federal-state structure which has evolved over the years.

Much of the historical development of our banking system has been "accidental"--in the sense of a reaction to immediate needs of the moment--rather than the result of careful planning. The Federal Deposit Insurance Corporation itself was born in a crisis, as was the Federal Reserve System. As a consequence, it can be said with some justification that the resultant Federal-state bank structure includes a number of features that are not germane to the current scene. Nevertheless, our present banking structure has helped to preserve and perpetuate the diversity which has been a major source of strength to our financial system. Admittedly, there have been some problems, but, on the whole, our banking system has performed well in recent decades.

With the tempo of change increasing today, it becomes particularly imperative that management be prepared to meet the challenges encountered in the course of banking operations. Our nation is facing larger and more complex--if not wholly new--problems at home, and conditions abroad are continually changing.

In preparing to meet the challenges and problems that may arise in our particular field of interest--banking, each of us can play an important role. Frequently, strong leadership at the state level may be decisive and produce substantial benefits for both national and state banks and for the public.

The passage by the Minnesota legislature of a bill to eliminate nonpar banking by November 1, 1968 provides an excellent example of

solution at the state level of a problem that affected not only state banks and national banks but bank customers and merchants beyond state boundaries as well. The indirect burdens imposed on others by the levying of exchange charges have been removed through enlightened state action--and the interest of the institutions directly involved have actually been furthered. The South Dakota Bankers Association is currently conducting a study of nonpar banking in South Dakota to determine what might be done in that state, while commendable progress has been made in Georgia in the conversion of nonpar banks to par banks. The nonpar issue is one that is particularly responsive to state initiative and leadership because the practice is restricted to a relatively small number of states.

The strengthening of state banking departments and the revision and modernization of state banking codes present yet another area in which state action can have important benefits for banking as well as for the rest of the economy. In this respect, Texas can take credit for measures taken over the past several years to modernize its banking code and strengthen an already excellent banking department.

The viability of banking within any state is heavily dependent on the caliber of bank management and on the overall strength and vigor of the state's economy. But the quality of state bank supervision and the extent to which it is supported by the state banking code oftentimes can spell the difference between a strong banking industry and a mediocre or even poor one. Undesirable and unexpected imbalances between state

and national banks can develop as a result of failure to update state banking departments and banking codes--with possibly serious, or at least troublesome, consequences for the state's economy. Each state must assume the responsibility to keep its banking system under continual review in order to ensure the necessary flexibility and adaptability essential to our times.

Brief mention might also be made of several other arenas in which states can exert leadership or take the initiative. Several states, for example, have enacted or are considering so-called "truth-in-lending" legislation, which is designed generally to provide a borrower with more and better information about the cost of borrowing so that he may make a rational decision in choice of lenders. The truth-in-lending bill currently under consideration in Congress, moreover, includes a provision that requires exemption of any class of credit transaction effectively regulated under state laws requiring disclosure of the same or substantially similar information. Currently, a Uniform Consumer Credit Code is in the process of being drawn up by the National Conference of Commissioners on Uniform State Laws, and cooperation at the state level was an important element in the development of the Uniform Commercial Code.

The so-called "cease-and-desist" bill, which was passed last year, requires advance notice to the state banking authorities by the Federal supervisors before action is taken against unsafe and unsound practices or against individuals who are personally dishonest, which

would tend to endanger the viability of a bank. Only in the event that a state is unable to effect the necessary remedy do the Federal authorities intervene. Consequently, those states that currently have not endowed their bank supervisors with such authority might consider the value of adding cease-and-desist powers to their regulatory arsenal. Cease-and-desist powers can be an effective and moderate means of obtaining compliance with conditions that are basic to the well-being of an individual bank.

One other area of current interest to state legislatures is the existence of differences in the tax treatment of state-chartered banks compared to the treatment of national banks. In some instances, state law has placed state-chartered institutions at a disadvantage in doing business within its own state. Such situations should be corrected.

In general, where the Federal-state approach has been adopted, I think that the state and Federal bank supervisory authorities should strive toward "competitive equality" for the institutions under their respective jurisdictions. The term "competitive equality" was used in the debates on the McFadden Act of 1927 in reference to branching powers of state and national banks. Broadly construed, the goal of "competitive equality" between national and state banks can be a constructive means whereby a healthy and dynamic banking system can be fostered.

Within the narrower context of bank branching powers, the issue of whether banks should be permitted to branch or not is one in which

state leadership can--and must under present Federal law--play an important part. The decision of the Supreme Court in December 1966 on the Utah branch banking cases--although it left a number of questions unresolved--places squarely on the states the responsibility for the decision on branch banking. The Supreme Court held that state laws on branch banking governed--on the grounds that the legislative history of the relevant Acts clearly "intended to place national and state banks on a basis of 'competitive equality' insofar as branch banking was concerned."

A discussion of branch banking is also appropriate today because the varying practices of the states constitute an outstanding reflection of the diversity of banking law in this country, which I mentioned earlier and which has been a major influence shaping the structure of American banking. The states now can no longer claim uncertainty about the locus of responsibility for bank branching powers under existing laws. It is up to the individual state to decide, for example, whether its present branching powers are appropriate for the present--and foreseeable future. This is an opportunity that must not be lost through inaction. The future development and expansion of our banking system could be irreparably damaged by failure to act.

Indeed, there is an element of urgency in the need for state bankers and state legislators to take a long and searching look at the whole issue of branch banking again in the light of the changing

financial environment and the outlook for banks and banking, irrespective of the case for or against branch banking generally. This is an issue, moreover, in which I have a strong personal interest as a result of a court test of Utah's restrictions on branching by a small bank in Utah, of which I was at that time president. But the issue in this case is one that is fully deserving of attention for reasons that extend beyond personal interest; it can have a far-reaching impact on the future of banking. Because of the diversity of state economies and their bank structures, moreover, a carefully considered reassessment could result in a number of different variations suited to particular sets of circumstances. What should be stressed here is the overriding duty placed on the states by the Supreme Court decision to take another look at branch banking.

There are many aspects of the branch vs. unit banking problem that might usefully be reexamined in the light of the findings presented in recent studies of the subject. So that you may view the problem in its current setting, the remainder of my remarks will be devoted to comment on relevant topics that will serve to highlight some of the crucial issues.

Consider, for example, the question of prospective costs facing an individual bank in deciding whether it would be desirable to embark upon a branch office program of expansion. A recent study, for example,

has concluded that additional banking offices increase labor costs because of the unavoidable duplication of personnel requirements. An active demand deposit business also requires more equipment. Physical plant requirements, moreover, are greater in a branch operation. The same study found, however, that there was little variation in material costs between a multi-office and a single-office operation.

At the same time, there are various sources of offset to higher costs in a branch banking operation. As the volume of banking activity grows, there are economies of scale that can only be obtained from an expansion in business as fixed costs are spread over a larger volume of business. There is evidence, however, that economies of scale may be limited beyond a certain size range; and that unit costs may increase beyond this point with the size of the bank.

Branch banking, however, could permit a bank to offer a wider variety of services through extension of its markets into areas not previously tapped. The more varied product-mix in turn could increase revenue derived from higher yielding types of loans, such as consumer loans and mortgages, or other bank services. The net impact on the bank's overall profitability, however, would depend not only on the increase in costs relative to revenues but on many other factors such as the overall liquidity of the bank.

Bank structure also affects the composition of a bank's liabilities. One study has found that competition for savings tends to be intensified where unit and branch banks co-exist. This interaction has significant implications for banking today when the competition for savings is so keen. During periods of strong competition for savings at rising rates--as occurred last summer--some banks may fall behind in the race for savings. If this type of situation persists and the demand for funds places heavy pressure on the flow of new savings, banks may find themselves struggling with indifferent success to maintain even their existing position. Bank management would be faced with a continuing challenge to its resourcefulness and imagination to operate in such a highly competitive environment. Competition, however, could be a healthy and invigorating influence in a community on both bank management and from the viewpoint of meeting the convenience and needs of the public more satisfactorily.

Meeting the convenience and needs of the public is one of the primary responsibilities of banks and one that bears repetition. It should be one of the principal criteria dominating bank management decisions on the types and amount of banking services. The "public" as used here runs the gamut from bank customers operating nationwide to the individual consumer whose financing needs are confined within a relatively limited geographical area. Neither one should be neglected at the expense of the other. On the other hand, the size of the individual

bank and the variety of services it offers--or is prepared to offer-- must determine the limits--both geographically and quantitatively-- within which it can operate most effectively and efficiently.

To meet the challenges of size and service, progressive and expansion-minded bank management must also choose the form and dimensions of growth within the limitations of the banking business. The costs of servicing a larger number of relatively small transactions, for instance, can be disproportionate to their dollar volume, although the use of computers and other management aids could help to reduce the unit costs of these smaller loan transactions. The possibilities for the organization of groups of banks are many and varied: merger with another institution, strengthening of the correspondent banking network, the formation of service corporations, bank holding companies, or various forms of common ownership of bank equities, to list some of the principal alternatives. Some of the choices provide more and better service for the bank's customers. Others, it must be admitted, have been used on occasion to circumvent state restrictions on banking operations or structure. Even in these instances, the alternative has some obvious limitations. To illustrate, mergers in nonbranching states produce a larger institution that is able to take advantage of certain economies of scale, but its markets tend to be geographically more limited than similar sized banks in limited or statewide branching states. On the other hand, there are doubtless a number of instances where the merger route may prove the appropriate solution.

These are just some of the major factors that deserve consideration and reexamination in light of current and prospective financial requirements of the economy. Because change is an accepted feature of today's financial scene, a periodic review of the issues, the problems, and the prospects in banking is the hallmark of alert, imaginative, and modern bank managers. The structure of banking within each state--although originally the result perhaps of historical accident--can be an important factor in the ability of our economy to keep pace with the changes that are continually taking place.

The FDIC occupies a subsidiary but strategic position in this picture. Our concern is with the health and vigor of the banking system and with its ability to serve the needs and convenience of the public. Our most effective contribution stems from the assistance that we can render during transition periods and by helping banks to adapt to change, and in stimulating a dialogue on issues. Accordingly, the impact of innovations such as bank credit cards and automation are followed closely. Even more positive steps are being taken through the conduct or sponsorship of studies, such as those currently underway, on bank costs and computerization that will enable both bank supervisors and bank management to assess more realistically than before the impact of change on bank operations. Studies of bank structure are even more basic. In these ways, the Corporation attempts to maximize its support of the banking system and its protection of depositors.