Department of the TREASURY NEWS
COMPTROLLER OF THE CURRENCY
THE ADMINISTRATOR OF NATIONAL BANKS WASH., D.C. 20219 447-1798

FOR RELEASE ON DELIVERY
May 19, 1975

[Electronic BANKING—EFTS]

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Remarks of James E. Smith
Comptroller of the Currency
Before the Annual Convention of
The Pennsylvania Bankers Association
Atlantic City, New Jersey
May 19, 1975

It is a particular pleasure for me to address the Pennsylvania Banker's Association this morning, for the National Banking System really started in your state. First Pennsylvania holds National Bank Charter Number 1, originally issued in 1863.

My message today deals with the present and future of banking, rather than with its honored past. Information processing technology now makes it possible for banks to serve the financial needs of their customers with far greater speed and convenience than was possible even a few short years ago. EFTS is the acronym used to describe the electronic delivery of financial services to the customer where and when he wants them.

To insure a common basis for understanding my views of electronic banking or EFTS, it may help to review the basic elements in a system. Computer terminals are normally linked to a bank computer by telephone lines. The terminal may be as simple as a touch-tone telephone or as complex as an automated teller machine. The important thing is that these terminals simply permit a customer to transmit transaction instructions to his bank. Thus the services may be made available to the customer where he is rather than forcing him to come to where the bank is.

Though the terminals are the most visible components in an EFTS system, the real action takes place in the programs and on-line account files on the bank's computer. These programs define the transactions that can be accommodated through the system and handle all of the accounting tasks for the customer and the bank.

Computer terminal networks are certainly not new. Airlines and retailers have been using them for years to log reservations and record sales. Some of the more innovative bankers had been seeking ways to employ this technology to better serve the consumer and a number of limited EFTS experiments were undertaken around the country.

Perhaps the most significant of these was the installation of simple $500 terminals in Hinky Dinky supermarkets in Lincoln, Nebraska, in January 1974. First Federal Savings and Loan of Lincoln had developed a system which would permit their customers to make deposits or withdrawals from their Savings and Loan depository account through these supermarket terminals. Thus, simple transaction services were made available to customers during store hours, 7-days a week in contrast to the limited hours of operation of First Federal's branches.

Of perhaps greater significance to the financial industry than the First Federal - Hinky Dinky experiment itself was the sequence of events surrounding the FHLBB "place of business" funds transfer regulation that made the services legal for federally chartered S&L's. First, a perceptive and innovative savings association manager discerned a customer need and developed a service to satisfy that need. When the regulatory status of that service was not clear, he sought enabling regulation to permit his association to employ existing technology in a creative fashion. The experimental regulation followed, to be further modified five months later based on experience rather than conjecture.

The Federal Home Loan Bank Board followed its initial regulation with a modification in May of 1974 and new EFTS plans were being translated into competitive services by an increasing number of savings and loans. My constituents, the national banks, started clamoring for clarification of their legal ability to compete. National bankers, banker associations and state regulators from 14 states approached the Comptroller's Office questioning the interpretation of federal law, the interaction of federal law with diverse state laws, the competitive balance within the banking industry and between banks and other financial institutions, and the future development of electronic banking services which will benefit the banking public and alter traditional banking methods.

In response to these forces for change, the Comptroller's Office initiated an exhaustive review of the law and began formulating a position on EFTS. The results of this review were published on December 12, 1974 as an interpretive ruling clearly setting forth as a matter of law and sound public policy that off-premise customer bank communication terminals (CBCT's) could be operated by national banks without regard to the restrictions contained in federal law regulating branch banks.

Underlying this interpretive ruling was the historic responsibility of the Office of the Comptroller for the establishment and development of a National Banking System and

the obligation implicit in that charge to periodically take account of the competitive environment facing national banks. That the competitive environment was substantially altered in January 1974 by the Federal Home Loan Bank Board is clear. My obligation to preserve and enhance competition, to assure that available technology could be employed to improve the quality and efficiency of banking service to the public, is equally clear.

The CBCT ruling was intended as a clarification of the non-branch status of these terminal systems and as the removal of a legal barrier to National bank competition with federally chartered Savings and Loan Associations. I recognized the potential state law problems faced by state chartered commercial banks and, at the request of the Conference of State Bank Supervisors, incorporated an "urged" deferral until July 1, 1975 for those national banks operating in states where legislation would clearly prohibit state banks from electronic competition. This deferral period allowed state legislatures to assess the EFTS issues and determine the appropriate legislation governing those state chartered institutions under their jurisdiction. Ten (10) states have enacted EFTS legislation, seventeen (17) more are expected to address the issues during the current session and twenty-seven (27) have existing legislation insuring competitive equity between state and national banks operating in their state.

This legislative progress is a genuine tribute to the state supervisors, bankers associations and individual banking leaders within each state. The issues are indeed complex and confusing, given so little actual experience to date.

I can not overemphasize the value of this experience, for regulation or legislation based instead on conjecture or speculation clearly runs counter to innovation in this preliminary stage of EFTS development. The minimal extent of our initial regulation represents a carefully considered decision that regulation should follow an experience curve and be limited to those situations where experience demonstrates the need for regulation. This position was substantially supported during the March 14 Senate hearings on S-245, the proposed EFTS Moratorium Bill, by testimony given by other Federal regulators, several industry trade associations, and the Department of Justice. As experience is gained, I shall carefully and decisively employ my regulatory authority to preserve and enhance competition in the public interest in accordance with my Congressional charter of accountability.

To gain maximum benefit from that limited experience gained by savings and loans and commerical banks alike, public hearings were held on April 2nd and 3rd. Thirty-five witnesses testified and several institutions filed prepared statements to aid our evaluation of the original CBCT ruling. The hearings reaffirmed the undesirability of premature or anticipatory regulation, for this would serve to stultify the optimum development of this technological development.

Witnesses described the variety of competitive options available to smaller banks which may lack the resources to independently offer their customers the convenience of EFTS services. Cautions were raised regarding systems security, consumer rights and liabilities, and the unrestricted geographic coverage of the initial ruling. We listended as intently to these cautions and concerns as to the enthusiastic support of the ruling by others.

One witness suggested specific revision to limit CBCT installations to a bank's home market area before any further geographic expansion were permitted. Such a limitation also would help to allay the fears expressed on behalf of small banks, and thus promote the healthy development of the banking system, both state and national, by focusing the attention away from an unproductive intraindustry dispute and toward the development of techniques to meet competition from other industries and to better serve the banking public. Others encouraged that some form of sharing be allowed so as to permit national bank participation in several regional, statewide or multi-state joint ventures currently in the planning stages. Though I do not favor sharing as a general rule, especially where a bank has adequate resources to competitively develop and install its own CBCT's, the argument for allowing sharing where consistant with anti-trust laws was persuasive.

Following the hearings, we carefully evaluated the testimony to determine the next regulatory step. A modification to the ruling was announced May 9 with the following major provisions:

-- CBCT's are definitely not branches. The Federal Deposit Insurance Corporation announced their support of this contention on Monday, May 12 and will soon issue a formal statement on the subject.

-- A mileage limitation has been imposed on CBCT's intended for the exclusive use of the customers of a single bank. A national bank is forbidden to establish a CBCT more than 50 miles from its main office or nearest chartered branch unless the CBCT is available for sharing at a reasonable cost with one or more

deposit taking institutions already serving the trade area of the proposed CBCT.

-- Consumer protection procedures including disclosure to customers of their rights and liabilities and safeguards against wrongful or accidental disclosure of confidential consumer information are now required by the notification process.

-- Permission has been granted for national banks to use CBCT's installed and owned by another bank or third party. The modified ruling also permits national banks to participate in statewide networks such as those legislatively permitted in Nebraska and Kansas, and contemplated in Missouri and Minnesota.

-- Specifically excluded from reporting requirements are those terminals whose sole function is to accomplish a verification or authorization function, a funds transfer for payment of goods or services, and through which neither cash is dispensed nor cash or checks left for subsequent deposit.

In addition, the May 9 modification makes quite clear our intent to consult closely with the Anti-trust Division of the Department of Justice to insure that no potentially anti-competitive activities or arrangements are permitted under this ruling. On the consumer protection aspects of the ruling, each notification will be reviewed by my Consumer Affairs Department to insure compliance with the spirit and the laws already enacted dealing with the relationship between a bank and its customers.

Congress quite clearly expressed its concern that EFTS be allowed to develop with a minimum amount of government regulation or intervention and a minimum of competition consistant with adequate consumer protection when it established the National Commission on Electronic Funds Transfer Systems last October. Though the Commission has yet to be formed, I strongly support its Congressionally imposed purpose and functions. The Commission shall enjoy a unique opportunity to draw upon the most capable people in the industries and government agencies represented and to elicit the broadest base of data from which to draw its conclusions. I am most anxious for the Commission to be formed and commence its great tasks, for the Commission findings should prove most valuable to regulators and the industry alike. Accordingly, I intend to imploy the May 9 CBCT Modified Ruling substantially unchanged until the final Commission report is available for guidance.

Thus, experience can be gained in a controlled and orderly environment, benefiting the Commission activities, and banks can proceed with their planning and capital investments for electronic banking without fear of the ground rules changing significantly during this phase of EFTS development. My intent is not to

provide protection for the unwilling non-competitive bank nor to establish a competitive advantage for any particular group of banks. Rather, it is to enable national banks to meet the competitive challenges of other financial and non-financial service institutions in a free market economy for the benefit of the consumer and banking industry alike.

Free market competition, however, does not imply lack of restraint or regulation. To the contrary, restraint must be exercised by banks in those situations where imprudent or unusually venturesome actions are likely to work to the detriment of the industry as a whole. A miximum of good faith and prudent judgement must be exercised by bankers and regulators, both state and national, during these early days of EFTS so as not to kill innovation through counterproductive and lengthy litigation.

This is the time for thorough assessment of all options available to a bank in its competitive forays. Simply because EFTS activities may now be regulatorily permissible, the basic business decision process must prevail. Capital adequacy and bank earnings must be critical factors in the evaluation of competitive options. Where a national bank serves a trade area which spans state boundaries, as is the case in a number of metropolitan areas, the bank would be well advised to consult with the state banking commissioners in both states before installing a CBCT under our regulation. This consultation should have as its objective, the reconciliation of bankers' competitive objectives and the state regulators' concerns for competitive equity on the part of their state chartered banks. I and my staff would welcome the opportunity to meet with the bankers and state regulators on an informal basis to work cooperatively and dilligently to achieve professional innovations in banking services for the public benefit. Some form of limited reciprocity agreements between state regulators is clearly perferrable to repeated and unnecessary litigation, though this office does not shirk from the prospect of future litigation.

In conclusion, it is my firm belief that reasonable people can agree on developments which break genuinely new ground for the banking industry and the public. Let us substitute reason and rational analysis for emotional response. Such is the task of the National Commission and so must be the charge to regulators and those who are regulated. Good faith and good will on all sides of the issues and a willingness to consult and work toward the establishment of informal agreements can permit much progress to occur, even in the absence of express legislation. by the states.

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