



NEWS RELEASE

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Director Irvine H. Sprague of the Federal Deposit Insurance Corporation today urged the appointment of a blue-ribbon presidential commission "in the very near future" to make a comprehensive study of banking and bank supervision.

Speaking before the State Bank Division at the American Bankers Association convention in Honolulu, Hawaii, Mr. Sprague said "We are already in the process of making changes in the laws under which the (bank) regulatory agencies operate, but we are making those changes without any overall study of the consequences they will produce for the entire system."

Noting that Senator William Proxmire and Representative Henry Reuss have recently called for a "top-to-bottom survey of banking and regulation, covering every phase of the flow of money and credit in the United States," Mr. Sprague said he thinks that is a "splendid idea."

He said he believes the study commission "should be appointed by the President; that it should be bipartisan; that it should represent the Congress, the Executive, the banking industry and the public."

"I think it is particularly important that there be a strong public representation on the commission," he told the bankers. "Too often, industry and its regulators act without really hearing from the public. We all try, I think, to act in the public interest. But since we talk mostly with one another about these problems, it is just possible that our idea of the public interest and the public's view of its own interest occasionally may be strikingly different."

Mr. Sprague also endorsed a finding by a recent report done for the National Association of Supervisors of State Banks that few regulatory agencies at federal or state level "think or act often enough in terms of public needs and convenience."

"It has been a long time since anybody pointed this out," he said. "The fact is that regulation in any industry tends to make comfort seem at least as important as competition. When that happens, someone has to take the initiative in restoring the competitive spirit."

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This is one of those times when it seems ridiculous to start a speech by saying it is a pleasure to be here with you. It would be a pleasure to be in Hawaii under almost any circumstances short of being handcuffed to a United States marshal -- and there are days here in the Islands when I wouldn't even rule that out.

It is, of course, sad to find some people in Hawaii taking a little of the fun out of their lives by being so self-conscious about how parts of the Islands have changed since World War II. This preoccupation with the new look even rubs off on tourists. And you know things are out of hand when you hear a man in a hotel lobby saying: "This is my first trip to the Islands and, I must say, they certainly have changed."

The question of change in Hawaii was settled permanently for me by a man who came here after twenty years or more and was asked whether he didn't think it looked different. He looked around and said: "Well, the sky is the same shade of blue. The clouds still bump up against the mountains the way they always did. The water is still a delight. No, I wouldn't say it has changed at all."

That attitude doesn't exactly mark him as a man of his time. In these closing days of the 1960's, few people can ignore change. Some are for it; some are against it; but nobody can overlook it. And so you have a continuing and fundamental debate over the kind of change we want.

Parents agonize over the methods of educating children. Children agonize over where they went wrong training parents. President Nixon has one of his most trusted advisors working full time to identify goals for a nation that once seemed to know exactly where it was going. There is

a widespread and apparently valid concern that one result of change is leading to pollution of our air and water beyond repair.

In fact, nothing is immune in this great soul-searching over the nature of change and the results we want from it -- not our role in Vietnam any more than the crime rate; not the length of women's skirts any less than controls on credit.

Because so much of the debate involves the way in which we are going to allocate America's resources -- and because it takes place in a period of inflation more prolonged than any in the past 20 years -- bankers and those of us in government who are involved with banking are very much a part of this soul-searching.

For some, whose primary concerns are more housing or better jobs or safer streets, the debate over banking may seem superficial, if not absolutely irrelevant -- dealing as it does with details of the structure of banking and its supervision.

But the fact is that this banking system will largely determine whether the financial community can deal with the changing needs of the American economy. And it will have a great deal to say about whether we solve the many problems we face the world over.

The Congress has before it now more crucial banking legislation than it has seen since the 1930's. None of it is trivial -- tax reform, easing the flow of credit to college students, mortgages, mutual funds and credit cards. And some of it -- like the holding company bill and tax reform -- is so basic that it could lead to major changes not only in the structure of the financial system but in the very definition of banking.

Then there are issues which are not yet before the Congress but which are certainly on their way. The recent study of the savings and loan industry by Dr. Irwin Friend of the Wharton School of Finance is one of these. It is only a matter of time before Congress is asked to answer some of the questions which are raised in that report. Should savings and loans, for example, be permitted to accept individual checking accounts, make consumer loans and, in other ways, move toward direct competition with commercial banks?

The Friend report is bound to intensify discussions on the basic issue that faces banking: Is the financial community as we now know it organized as efficiently as it must be to meet the needs of the country? Does it make sense to have a commercial bank, a savings and loan association and a mutual savings bank on three of the four corners of a downtown intersection with a finance company on the fourth? Or have we been too clever in dividing the responsibilities for furnishing credit and protecting savings? Would both banking and its customers be better off if banking institutions in the broadest sense were competing with one another in all fields of financial service -- assuming, of course, we can ever agree on what financial services are.

One difficulty with the whole range of banking issues before Congress is that they are like a bowl of peanuts. It's hard to stop with just one.

In its present form, for example, the one-bank holding company act would redefine banking activities for holding companies. The next peanut is whether Congress should then redefine banking for all national banks, as well as for holding companies. The next is the question of

whether national banks ought to be allowed to provide services which state law prohibits state-chartered banks from offering.

If holding companies can, for all practical purposes, branch, can Congress deny that power to individual national banks? And if national banks could branch, how long would states withhold that power from their own banks?

Ironically, since the debate over one-bank holding companies that opened up these questions began early this year, one curious thing has happened. Many of the companies that had rushed to reorganize into holding companies have begun to ask whether that really is a pot of gold at the end of the rainbow or just a pot. It has been clear for some time now that data processing is not necessarily a profitable enterprise for most banks. And many bankers now are asking whether some of the other supposed benefits of operating as a one-bank holding company are valid.

The future of bank supervision -- at least for those of us at FDIC -- is about as clear as the future of banking at this time.

We are fundamentally an insuring organization. And yet we now share the responsibility for enforcing the Civil Rights Act of 1968 which makes it a Federal offense to discriminate in extending credit for housing. We share responsibility for enforcing the Truth in Lending Act and for making certain that banks not only do not pay above the legal rate of interest for deposits but that their advertising of rates is not misleading. We are responsible for helping more than 7000 banks decide what kind of equipment they need to protect themselves against holdups.

It has been suggested in at least one study that these responsibilities are incompatible with our basic job -- that we have a basic no-risk bias as a result of our insuring responsibility that clouds our judgment in other areas of supervision, particularly with respect to public needs and convenience.

Personally -- and I want to make it clear I am not making Corporation policy here today -- I do not accept that judgment as valid. I don't think any of us at FDIC have any illusions that banks fail because their managers are trying too hard to improve service to the public. I have visited all eight of the banks that have closed so far this year and in each case the failure was caused by bad judgment or by outright fraud.

The largest of these banks had deposits of \$10.4 million; and the smallest was a \$1 million bank. Six were state banks and two were national banks. And the basic flaw in most of them was poor judgment on loans. None of them went broke trying to outproduce another bank in serving its customers.

I have some other reservations about the recent study done for the National Association of Supervisors of State Banks as well, although I am in complete agreement with its goal -- to build stronger state banking departments.

The authors of the report, Carter Golembe and Charles Haywood, have made a game effort to find an approach and it may well be that over a period of time it can be made to work.

Unfortunately, I think the rating system they propose for state bank departments is too much like the problem of who will bell the cat. I can't speak for all of the mice at FDIC, but I think I can safely say that it would take a braver mouse than I am to advise a governor that he didn't measure up -- knowing full well that the rating would eventually make a headline in a newspaper and become part of his opposition's campaign material the next time the governor was up for reelection.

But I do not want to appear to be preaching defeatism on this measure. I think the NASSB is to be commended for making an effort to achieve higher standards for state bank supervision around the country. Whether the approach in the NASSB report is the right one, only time can tell.

But on one point I am in complete agreement. The report says that while the supervisory agencies are quite diligent about examination and protecting soundness and preventing fraud, very few of them -- including the FDIC -- think or act enough in terms of public needs and convenience.

It has been some time since anybody pointed this out. The fact is that regulation in any industry tends to make comfort seem at least as important as competition.

When that happens, someone has to take the initiative in restoring the competitive spirit. And I certainly endorse the Golembe-Haywood notion that state banking departments should do just that.

The NASSB report has also been helpful in another way. It has helped to draw attention to the fact that there is very little coordination of the many efforts to tinker with the basics of banking that are going on in and out of Washington.

The banks are busy trying to decide what banking is. The government is trying to decide what regulation is. And the effect is very much like what you would get next month during the World Series if you had one camera covering each position and no camera focused on the entire playing field.

So, at the risk of sounding like a bureaucrat whose answer to every problem is that it needs more study, I must say today I think banking needs more study.

Senator William Proxmire and more recently Representative Henry Reuss have proposed what they called "blue ribbon" commissions to make a top-to-bottom survey of banking and regulation, covering every phase of the flow of money and credit in the United States and I think that is a splendid idea.

It isn't as though banking has not been studied enough recently. There is material from studies and hearings spread all through the 1960's. But none of the studies has had the broad base that Senator Proxmire and Congressman Reuss propose. They want a commission that would represent the Congress, the Executive branch, the banking industry as well as its competitors, the state agencies and the public. And what they want it to study is everything -- branching, chartering, the structure of supervision as well as of banking, reserves, nonbanking activities and all of the other controversial subjects that must be studied if we are to achieve a true financial system in this country.

I think it is particularly important that there be a strong public representation on the commission. Too often, industry and its regulators act without really hearing from the public. We all try, I think, to act in the public interest. But since we talk mostly with one another about these problems, it is just possible that our idea of the public interest and the public's view of its own interest may occasionally be strikingly different.

As I said, there is no shortage of committee and commission reports on banking and there is almost no end to the variety of their recommendations.

There has been a proposal, for example, to transfer the Comptroller's office and the FDIC into the Federal Reserve System. Some have proposed a new Federal commission to consolidate the duties now shared by the three Federal agencies. One plan would take all supervisory duties from the Federal Reserve and assign them to the Comptroller and FDIC.

There is, as nearly as I can tell, no proposal to abolish all three of them, but I suspect that has been advocated in a bank president's office here and there over the years.

I might say, parenthetically, that one proposal would abolish the Board of Directors of FDIC and place its functions under the Secretary of the Treasury, so I am well aware that I am asking for a study that could very well cost me my job. I am willing to take that chance because I think it's important to make this study. Unfortunately, I have also been in Washington long enough and watched the speed with which things move long enough so that I am aware I am not taking a very big chance.

In introducing a bill calling for his study, Senator Proxmire told the Senate he thought the commission should appraise "the role of banking in the national economy with a view to determining whether existing State and Federal statutes, regulations and bank examination procedures promote vigorous competition in the banking industry and in the economy consistent with reasonable safety of depositors' funds."

The dangers of tinkering with the system one piece at a time have, I think, become fairly clear during the past year of inflationary pressures on the banking system. It seems clear to me, at least, that banking is a system in the same sense of the word that an engineer uses it. It seems clear that, as in any other system, tampering with one part has consequences for all the other parts. And unless adjustments are made elsewhere in the system to compensate for any major change you may have in mind, you can wind up doing more harm than good. To use an analogy that may not be very flattering but is certainly accurate, the banking system reacts to pressure the same way a hydraulic system does. If you build up pressure in the system and there are weak spots in it, they will leak.

You may have seen a recent report in the New York Times that the Administration is considering changes in the Federal banking agencies. Competing as it does for attention with inflation, defense, Vietnam, health, poverty and other national concerns, a change in banking supervision probably does not have a very high priority, but it is under consideration. And I am told that the form it is taking so far is mostly a review of the many recommendations which have been made during the past ten years to see whether any one of them or any combination of them seems desirable for the 1970's.

And it is just such an effort that seems to me to make the kind of blue-ribbon commission study I am suggesting all the more urgent. As I have said, any change in the system has consequences all the way up and down the line. I know that some of the top people at Treasury have -- in the past, at least -- felt the same way. And I can only hope that they would support the proposals by Senator Proxmire and Congressman Reuss for a major study.

It is, of course, perfectly possible that we are not wise enough to construct a system that will operate smoothly under whatever kinds of stress we are capable of applying to it. I do not believe that is the case, but if it is, the sooner we know about it the better.

In the recent calls for such a commission study, there is general agreement -- which I share -- that the commission should be appointed by the President; that it should be bipartisan; that it should represent the Congress, the Executive, the banking industry, and the public interest. Simply calling for such a commission study is not going to make it happen. You create as much controversy by asking for a study of change as you do by implementing the change itself. There are many people in the banking industry who like the structure precisely as it is. There are others who are dissatisfied but are concerned that they might find themselves even less satisfied under some other structure as yet unknown.

Finally, I would hope that such a study could get underway in the very near future. The history of government commissions often makes it hard to argue with people who regard studies as stalls. Some of them -- and perhaps even most of them -- are just that. But it seems to me that this is different. By the near future, I mean before the end of this year -- certainly before we lose the services of such outstanding men as Kay Randall and William McChesney Martin.

We are already in the process of making changes in the laws under which the regulatory agencies operate, but we are making those changes without any overall study of the consequences they will produce for the entire system.

Time and the market are not going to wait for us to decide what changes are needed in government and banking to serve the American economy during the 1970's.

We have a unique opportunity to apply the lessons of the past to the problems of the future and I think we should act now.

Thank you.