THE CHALLENGE TODAY TO SAVINGS BANK MANAGEMENT

Remarks of

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The Golden Anniversary you are celebrating made me inquire about the nature of the mutual savings bank industry back in 1920. At that time, there were more than 600 mutual savings banks, but with average assets of only $9 million, and industry-wide footings of only $5.6 billion. Savings bank life insurance had yet to be offered beyond the borders of the Massachusetts Commonwealth, only 40% of the industry's funds were invested in mortgage loans, and there was a comfortable spread between net operating income and dividends paid to your depositors.

The total number of savings banks has slipped below 500 since then, but the assets committed to your care are significantly greater and now average $150 million for each savings bank or more than $74 billion in the aggregate. You play a decisive part in the national mortgage market and offer a breadth of deposit instruments and financial services not even dreamed about in 1920. At the same time, you face uncertainties of both present and future. Your ability to handle these uncertainties, in the face of insistent public pressure on all banks to help solve the monumental capital investment needs of our times, represents the great challenge to savings bank management today.

During all of 1969, mutual savings banks were able to increase their deposits by only $2.6 billion, a figure well below deposit gains of the two preceding years and the first time in recent history that the gain was less than the dividends credited. The quarter by quarter figures showed an acceleration of this negative deposit trend which continued through the first quarter of 1970. The fact that interest rate ceilings on your deposit accounts have been below market rates throughout the period is an important factor in this disappointing record of deposit performance, but it is not the only factor. Back in the last half of 1966 and in almost all of 1967, a significant differential also existed, yet deposit inflows to the mutual savings bank system were exceptional.

What has happened, in this unusually long and unrelieved period of tight money, is that depositors have been increasingly educated to the availability of much higher yields on Treasury instruments and high quality corporate bonds. As the rate differential widened and as the money markets sustained these higher rates for a longer and longer period of time, depositors became less and less reluctant to enter these unfamiliar and relatively inconvenient markets. The urge to withdraw, in other words, has cumulated and intensified in direct proportion to the size of the rate differential and the length of time it has continued. Most analysts see only a slight downturn of rates on these investment alternatives in the foreseeable future, largely because of the tremendous backlog of long-term financing needed by State and local governments and by American business. If this prediction holds true, further disintermediation of your deposit totals is likely, unless the differential between the rates available in the capital markets and the rates you can pay on deposits is substantially narrowed, or unless the nosedive in the stock market and a general uncertainty about the economy rubs off psychologically on your depositors.

A step toward narrowing that differential was taken by the three Federal bank agencies in January of this year when they permitted 6% to be paid on low denomination time deposits maturing in two years or more. Authority for savings banks to offer this type of account was enacted in New York at my request in 1968 and is available in several other States as well. Until the January rate change, however, there was little incentive for a depositor to accept, or a savings bank to offer, a time account which could pay only the same rate of interest then available on regular savings accounts. Your experience, and that of the savings and loan industry, in aggressively merchandising these new time deposits will be extremely important when the Federal agencies consider whether a further narrowing of the differential is likely to improve desposit inflows to the mutual thrift institutions.

Your deposit experience may also reflect the changing attitudes and habits of a public which is increasingly at home in an economy of consumer credit and which has no deep-seated commitment to the value of regular cash saving. Even if this factor must be minimized under present market conditions, its influence may increase in the future as a whole new generation of young people reaches maturity.

The downward deposit trend which the savings banks of the country have been experiencing, and the uncertainty of its duration, have necessitated a variety of operational adjustments. Primary liquidity has had to be maintained at unusually high levels, while mortgage commitments have been steadily reduced over much of the past year, with a slight increase only in the last two months. Each of these necessary actions tends to have an adverse effect on operating income, which is under pressure for other reasons as well. Higher dividend costs, for example, must be expected from the rates now authorized and available on longer term time deposits. Some banks have had less of a cash flow for higher-yield investments than they expected because large numbers of home buyers have succeeded in assuming preexisting mortgages at rates below today's market. Other banks, locked into low-yield bonds and depreciated common stocks, are reluctant to write off increasingly stiff losses against their general reserve accounts and thus cannot realize the higher yields which might be earned through reinvesting the proceeds of such sales.

The result of these downward pressures on your earnings picture has been a corresponding upward pressure to maximize the net income to be realized from the funds that are available for long-term investment. Those investments with the highest yields and the lowest carrying costs are thus the most "desirable" in terms of earnings, and the investment statistics seem to bear this out with substantial dollar increases in high-quality corporate bonds, nonresidential real estate loans and conventional mortgage loans on income producing, multi-family dwellings, none of which in the usual case is subject to State usury ceilings. Many savings banks, however, have continued to serve their local mortgage markets despite yields that are below the highest available.

Coming at you from a different direction than these internal operating demands, are the growing demands from the public sector that all our financial institutions - pension funds, foundations and insurance companies as well as banks - participate more heavily in the financial solution of the social problems of our times. In your case these demands have been focused on the growing imbalance between the demand for adequate housing and its supply, and on the whole gamut of urban renewal and rehabilitation needs. New efforts to channel institutional money into these areas will undoubtedly continue as governments at all levels struggle to match their year-to-year tax revenues with the priorities established in the political process.

What remains uncertain is the amount of money which will actually be invested or reinvested, utilizing these channels, by voluntary action of individual boards of directors and trustees throughout the country - particularly those that are under the intense pressure to maximize earnings that you are. The urban reconstruction programs announced so far by the various segments of the financial structure offer scant encouragement as to the extent of voluntary action, for they fall far short of the commitment needed, either as a percentage of total industry assets or as a percentage, for individual participants, of their own total assets.

Of one thing we can be absolutely certain: the social problems giving rise to these efforts will still be with us fifty years from now, if the people's savings are not directed in the interim to their solution. In such an eventuality, I have no doubt that more radical solutions will be proposed by insistent legislatures seeking to hold all financial institutions accountable for serving the public needs and convenience as *they* define that term.

It seems appropriate, then, as the mutual thrift institutions wrestle with their current operational problems and with the social demands being placed upon them, that their longer-run problems are to be carefully reviewed by a Presidential Commission on Financial Structure and Regulation. The President's Economic Report set the following framework for the Commission's work by stating:

> "Throughout our history the government has been involved in regulation of the financial markets. Such regulation serves three broad purposes: (1) It provides for an appropriate money supply and efficient operation of the payments system; (2) it protects the public from loss due to financial failures, as well as from misrepresentation and fraud; and (3) it encourages and subsidizes the allocation of credit to particular sectors."

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> "While the ultimate objectives of Federal involvement in the financial sector are clear, the problems and costs do not always receive sufficient attention. The direct costs to the government and the public of imposing restrictions on financial institutions may not seem large, but an important cost easily overlooked, because it is difficult to quantify, stems from the inflexibility of regulations once they are issued."

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> "Mortgage financing and the role of interest ceilings need reexamination. Savings and loan associations need greater flexibility to adapt to market developments, and new sources of funds for the mortgage market need to be devised. Given the consequences of four decades of deposit-rate ceilings, they cannot be suddenly removed without serious financial disruptions. Some basic reforms in financial regulations are, however, needed.

"Our expanding and increasingly complex economy must have financial institutions reflecting the vitality that comes from vigorous innovation and competition. Financial services required by tomorrow's economy will differ in as yet undefinable ways from those appropriate today.

"The demands of our flow of national savings will be heavy in the years ahead, and our financial institutions and financial structure must have the flexibility that will permit a sensitive response to changing demands.

"Thus the time has come for a thorough examination of needed changes in our financial institutions and our regulatory structure."

This group should be heartened by the intended focus on mortgage financing, rate ceilings, and the need for flexibility if innovation and competition are to be encouraged within the nation's financial system. The Commission, for its part, should make a significant contribution toward resolving the basic long-term question with which the savings bank industry is faced today: Will the savings bank system remain relatively specialized in authorized powers in order to assist the allocation of credit to particular sectors of the economy like housing, or will it become a more generalized, full service institution like a commercial bank, precisely because it cannot allocate funds it is unable to attract in an increasingly competitive deposit market?

If the Commission's answer is that a more generalized institutional structure should be encouraged, how will the nation then be assured that its available credit will be allocated among competing demands in the order of priority demanded by the people? How will a mutual institution competing with a commercial bank be able to hold its own in the competition for long-term capital funds as distinct from deposits?

These are difficult questions which must be answered if savings banks and their supervisory agencies are to be able to plan ahead. We at the FDIC look forward to working with you and with your State supervisors in a cooperative effort to meet the banking needs of the people. Together we must seek to answer the challenge of these times without weakening the financial strength of the nation's savings banks, or the exceptionally high degree of confidence which the people have placed in them.

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