



NEWS RELEASE

FOR IMMEDIATE RELEASE

PR-54-71 (10-21-71)

CHALLENGE AND RESPONSE IN BANKING TODAY

Address of

Frank Wille, Chairman
Federal Deposit Insurance Corporation

October 18, 1971

Before the

97th Annual Convention

of

The American Bankers Association

San Francisco, California

The last few years have brought forth so many predictions of change for the banking industry and so many varied demands that banks pay more attention to this problem or that problem that we are all in danger of losing a sense of perspective and balance. To those of you who feel beleaguered, misunderstood, or helpless in this environment, my message this morning is to take heart: the record of the industry as a whole -- for adaptability to change, for improvements in banking service, for community concern, and for profitability -- is a cause for optimism, not pessimism. To those of you who are in the forefront of the industry's response to these changes and demands, I commend you for your leadership and confidently predict, again based on the record, that more and more banks will follow your example and put to good use the experience you have gained. In this process, it is the American people -- your customers -- who will gain the most.

The predictions of change we all have been hearing center on the bank holding company movement now under way as a result of last year's amendments to Federal law and on the possible recommendations of the Presidential Commission on Financial Structure and Regulation later this year. Both are likely to lead to more intense competition in the provision of financial services to the American people than bankers have ever known, but if the bank holding company movement provides the flexibility many now foresee, if the Commission lives up to expectations and if its recommendations are implemented by administrative and legislative action, the tools to meet that competition are likely to be available to all banks that need them.

The Federal Reserve Board has moved promptly to provide the specific guidelines which were needed for the development of bank holding companies in the future. Small banks as well as large now recognize:

- That the 1970 amendments have given the Board a continuing authority, not limited to the items specifically mentioned in Congressional debate, to define and redefine those non-bank activities which in its judgment are so closely related to banking or managing or controlling banks as to be a proper function for bank holding companies;
- That these activities, because of procedural changes made in the same amendments, can be formulated with dispatch by general regulation and need not await case-by-case decisions on individual applications, thereby providing greater certainty, faster, for a wide variety of business decisions that banks and their parent companies must make;
- That these activities may be performed, subject to possible limitations in individual cases, at locations where a subsidiary bank, bound by State law, could not locate one of its own offices -- a flexibility that may encourage more

- more -

and more banks to move traditional bank functions into separate non-bank corporations that can operate throughout the bank's natural market regardless of the location of its branch offices;

- That these advantages of certainty, speed and geography, together with the elimination by law of any distinction between one-bank and multibank holding companies, have given tremendous and increasing impetus to the bank holding company movement in this country, to innovation and experimentation in the kinds of acquisitions being made, and to the formation of multibank holding companies wherever State law does not specifically prohibit them.

What large bank holding companies can legally do, small bank holding companies can also legally do, and many of you will also seek to take advantage of the new possibilities in such areas as mortgage origination and servicing activities, small loan company operations, and insurance agency activities. The differences in practice between holding companies of different size, as with large banks and small banks, will arise from differences in markets, differences in management capabilities and policies, differences in capital and differences in operational efficiency. But it would be a mistake to believe that the bank holding company movement now underway is available, as a practical matter, only to large banks.

The Presidential Commission has been examining topics of equal, if not greater, importance to the future of banking in this country. If comprehensive and inter-related recommendations are made on such items as (i) the ability of the banking system to attract deposits and other investable funds on an equal footing with mutual thrift institutions, (ii) the possible elimination of existing differences between such institutions and commercial banks, both as to powers and obligations, and (iii) new incentives to provide home mortgage money to the American public, equally applicable to commercial banks as well as other financial institutions, then truly profound changes may be in the making. Again, you may face new competition, but you would also be gaining the tools you need, and the opportunity, to meet that competition.

How well, you may ask, will commercial banks, particularly the average bank, the small nonmember bank of \$10 or \$20 million in deposits, be able to weather these structural changes? If past experience is a guide, the answer must be: quite well indeed. And if the bank holding company movement and the expected recommendations of the Presidential Commission give you greater capacity to compete than you have had heretofore, the results may be even better than past experience would lead us to expect.

In the years since 1960, small banks have accommodated to, and themselves offered, many of the banking services first introduced by much larger banks.

These would include, to mention only a few, time certificates of deposit in small denominations, Golden Passbook accounts, bank credit card arrangements, and computerized service for many customer accounts. Small banks also have been in the forefront of the move toward drive-in facilities, longer banking hours and minimum or no charge checking accounts. Many have initiated moves to higher rates of interest on savings accounts.

During the 1960s, significant structural changes occurred in many States because of changes in branch banking laws, or in laws affecting the formation of multibank holding companies, or in the utilization of pre-existing law. In each of these States, small community banks continue to operate competitively and profitably.

Throughout the nation, new banks continue to be chartered at the rate of almost 200 per year, a figure which almost invariably exceeds the number of banks eliminated each year by merger or consolidation. By contrast, bank failures have averaged less than five each year since 1960, an infinitesimal percentage of the 14,000 banks in the country. The number of branch banks continues to increase each year across the nation, but almost 10,000 single-office banks remain in operation.

The FDIC recently completed an analysis of 1968 cost data from some 972 banks around the country to determine whether new light could be shed on questions of economy of scale, and here, too, the results should be encouraging to smaller banks. What the Corporation did was to relate volume to direct operating costs for a specific bank activity, holding other characteristics of the same activity constant by standard statistical methods. If the costs increased at a slower rate than volume, usually as measured by the number of accounts, we concluded that economies of scale were present. On the other hand, if total direct operating costs increased at a faster rate than volume, diseconomies of scale would appear to be present and if the rates of increase were equal, than neither economies of scale nor diseconomies of scale existed. We did this for seven basic commercial bank services: demand deposits, time deposits, installment loans, business loans, real estate loans, securities investments and safe deposit box services.

We found for servicing demand deposits, a function which accounts in the typical bank for a majority of bank employees and for the largest component of direct costs, that for a 10 percent increase in accounts, cost increased only slightly less -- 9.68 percent. For three other functions -- time deposits, installment loan functions and safe deposit box services -- we found no significant economies or diseconomies of scale. Size does seem to bring economies of scale in only the three areas remaining: business loans, real estate loans and securities investments. But if we bear in mind that economies of scale appear to be small and decreasing or nonexistent in the three bank

activities that typically account for over 60 percent of total direct operating costs and 70 percent of total employees -- that is, the servicing of demand deposits, time deposits and installment loans -- then we can more easily explain the continuing ability of small banks to show healthy operating profits despite their reputed disadvantages in cost based on small size.

My six years as a State supervisor and my observations over the last eighteen months both lead me to the conclusion that given the will to compete, small banks can do so profitably and successfully despite structural change in their markets and despite wide variations in economic conditions. There is no reason at this juncture to expect a different result in the future.

I believe further that the banking industry is responding with increasing effectiveness and imagination to the demands that it take a greater role in the handling of some of our most difficult community problems. Banking's record, after all, is far better than the public realizes.

The vast majority of the country's 14,000 banks are locally oriented community banks. They were chartered initially to serve the banking needs of individuals and business firms in a specific area, and they have grown and prospered in direct relation to the economic and social health of the community around them. They are accustomed to lending to the local businesses that produce jobs, to the individuals who own homes in the area, and to customers of local merchants. They have invested for years in the debt issues of State and local agencies, many of them earmarked for such items as sewage treatment plants, parkland acquisitions, school construction, transportation improvements and housing. Their chairmen and presidents sit on civic boards of all kinds in virtually every community in this country. Is it any wonder, with this record, that they are perplexed by a Harris poll that finds so many Americans critical of their role as community leaders or that they are irritated, rather than inspired, by the new demands they read almost daily that they become "more involved" in their community's problems?

A growing number of banks recognize that part of the problem here is publicity -- or more accurately, the lack of publicity. If the banking industry is ever to get the community recognition it deserves, the public must be better informed, and more frequently informed, about the investment decisions banks make and the economic activities in the local community that these decisions help to finance. The meaning of these investments should be explained in terms of jobs, or sales, or homes, or the quality of life in the community. Your customers, in short, need to be educated about the business of banking in terms that are meaningful to them and relevant to the lives they lead.

Even more encouraging in the increasing recognition by banks that the public today expects and wants them to be corporate citizens in their communities, not just an impersonal financial conduit. The following are recent examples of this change in emphasis, with excellent returns, I might add, by way of community identification and goodwill, for the banks involved.

- One community bank, in a county faced with a large summer influx of teenagers and a local economy marked by unusually high rates of unemployment, advertised the problem, distributed 50,000 flyers to local homeowners and businessmen, most of whom had never hired summer help before, and matched up the available jobs with the available manpower. The result: jobs for hundreds of teenagers and a potentially troublesome community problem defused. Other banks elsewhere in the country have used the same techniques to match volunteers with needed hospital and civic work.

- An urban bank recently ran a series of recruiting ads for the city's police force, describing it as "the toughest, dirtiest, most satisfying job in town". The result: highly qualified recruits and greater understanding and appreciation of police work by the general public.

- Another urban bank, which supplemented Federal funding with \$150,000 of its own money, started a 16-20 week course for school dropouts and other handicapped and disadvantaged persons who could not find suitable employment on their own, paying them a living wage during the course, counseling them along the way, and putting them to work at secretarial and clerical jobs in the bank upon completion. The result: more than 400 graduates, who might otherwise be charges on society at large, productively employed by the bank in highly needed job categories.

- A registered bank holding company, in a unit banking state, organized and capitalized a new bank in an urban ghetto, with a specific mission to help the economically underprivileged. The result: the bank has brought financing to many ethnic small businesses and home ownership to hundreds of people who never owned a piece of property before, thereby offering hope to others and reducing urban tensions in a city torn by violence only five years ago.

- Banks throughout the country are publicizing the problems created by environmental pollution, refusing loans to polluters who might be subject to class action suits and extending credit at favorable rates to companies that are installing antipollution devices. One bank holding company system offers a special CD, the proceeds of which are earmarked for just such loans. The result: financial pressure on those responsible for desecrating our natural resources, and an assist to more direct government efforts to reverse the trends.

- more -

More and more banks, it seems, are rethinking their priorities in investment decisions and their priorities in the utilization of management time, skills and experience. Hard choices with limited funds and limited manhours are involved, and the choices made will no doubt vary with different managements and in different communities. What is new and hopeful in this allocation process is that bank managements are going beyond the traditional questions of legality, creditworthiness and conformity with an established investment category. They are looking at the long-run consequences to their communities of one loan or investment rather than another, recognizing that an affirmative answer to one prospective borrower may mean that another, possibly more deserving community enterprise, will not be able to get off the ground.

Banks today are active in almost every area of community concern, and we are fortunate that most of them know that a healthy and prosperous community means a stronger and more profitable bank.

I close with confidence that the banks of this country will continue to respond, effectively and successfully, to the challenges they face in a changing society.

#