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COMPETITIVE EQUALITY AND THE HUNT COMMISSION REPORT

Address of
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Before the
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The growing debate over the Hunt Commission Report reflects not only an awareness of the fundamental changes in the financial structure which would follow adoption of its recommendations, but also the very great difficulties which lie in wait for any group which attempts to bridge longstanding differences between financial institutions operating in the same market. Those of you who have sought new powers for commercial banks or thrift institutions under your supervision or possible changes in State law as to the branching rights of either know precisely what is happening now to the Hunt Commission Report. Those who think the recommendations strike at their vital interests are seeking to bury the Report. Others who think vital interests of the public were ignored may seek the same result. Those who object to some points in the Report, but believe they can live with the rest, are suggesting changes. A few will urge adoption of the Report in its entirety. The variations will be numerous, and the outcome at this juncture is far from clear.

By and large, State supervisors and State-chartered banks, particularly smaller State-chartered banks, have reacted skeptically, if not negatively, to the Hunt Commission Report. This reaction is understandable, even justified, but I believe there is room for a more positive reaction as well. First of all, the debate on the Hunt Commission Report is only now beginning in earnest. Congressional attention on the Report this year is unlikely but highly probable next year. You have not only an opportunity to publicize the ways in which the Hunt Commission Report will affect your segment of the dual banking system, but also an opportunity to suggest to the Administration and to the appropriate committees of Congress how, specifically, the recommendations of the Hunt Commission can be modified so as truly to strengthen State banking throughout

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the country. Secondly, the Hunt Commission Report makes a number of recommendations -- not limited to the question of Statewide branch banking -- for legislative action at the State level. These include (I) authorization for variable rate mortgages and a variety of consumer safeguards, including disclosure requirements, in connection with such mortgages; (II) abolition of statutory ceilings on the interest rates allowed to be charged on residential mortgages; (III) simplification and modernization of mortgage origination and foreclosure procedures; (IV) the abolition of barriers on out-of-State financial institutions that provide mortgage loans or hold property in your State; and (V) permission for multibank holding companies to maintain a single affiliate to carry on the trust activities of all subsidiary banks and to operate systemwide common trust funds. You can initiate action on all of these recommendations in your own State legislature and on the branching question you can support at least a factual review of the consequences of restrictions which may presently be contained in the laws of your State. Thirdly, although the Hunt Commission Report seems to assume that Congress or the Federal agencies will be the appropriate bodies to act on most of its recommendations, many of its recommendations -- particularly those that relate to the operating powers of supervised institutions -- can also be adopted at the State level for State-chartered institutions, frequently with far greater dispatch than an Act of Congress. Not suprisingly, the Hunt Commission recommendations in this area have been largely derived from State-law provisions or State administrative practice already in effect for State-chartered institutions in some States. You have, in short, a golden opportunity to make an affirmative case for State-chartered banking and for the responsiveness of State governments to a changing competitive environment which affects all of the nation's financial institutions.

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One of the basic principles that guided the Hunt Commission in its deliberations and recommendations was the belief that after a transitional period, all institutions competing in the same market should be required to do so on an equal basis. "Competitive equality," however, is a concept far easier to articulate in a report than it is to implement in the market place. It is a fair question, indeed an inevitable question, to ask whether adoption on the Commission's recommendations would in fact accomplish "competitive equality" among institutions in the same market.

In my view, the Commission's recommendations go a long way toward its stated goal of competitive equality in the market place, but they fall short in several important respects.

Take the matter of taxation. An equal tax burden is a basic ingredient for "competitive equality" among institutions in the same market. The Commission recognized this, but its recommendations (E1 and E2) are no more detailed than a single sentence urging Congress to enact a uniform tax formula - first for all deposit institutions offering third party payments (with a five-year phase-in period for mutuals that now do not offer third party payments) and later on for all deposit institutions. This asks all deposit institutions to take a great deal on faith in an area where the track record provides little ground for optimism that a single tax formula can be developed which treats both stock and mutual institutions with equal fairness, even less optimism that such a formula can be enacted expeditiously and without substantial amendment, and no optimism at all that the formula would work in practice the way it is intended. Moreover, if the rest of the Hunt Commission recommendations are designed to give institutional management the necessary authority to specialize by management choice rather than by statutory or administrative

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requirement, there is an added danger that the tax formula eventually enacted could impose such incentives or such penalties on the available choices that it becomes unrealistic to talk of management discretion or options. This in turn could distort, if not defeat, the thrust of the Commission's recommendations outside the tax area, and the possibilities here are compounded by the fact that the Commission's recommendations will be split up in the Congress and referred to different committees for separate hearings and independent study. The coordination problems are not insurmountable, but the difficulties along the way fully justify the caution now being shown by both commercial banks and thrift institutions to whom equality of tax burden is part and parcel of the concept of "competitive equality."

In its recommendations on operating powers, the Commission achieves a large measure of equality for institutions competing in the same market -- but important differences would remain, and these differences could seriously affect the financial abilities of different types of institutions operating in a world without Regulation Q. Commercial banks would continue to be the principal lenders to American business and only they could offer checking account services to business firms. As a result, commercial banks would be likely to continue having loan portfolios of relatively shorter term than deposit thrift institutions, with consequent advantages when interest rates are rising and disadvantages when interest rates are falling. Mutual savings banks and savings and loan associations, under the Commission's proposals, would appear to have a greater authority than commercial banks to invest for their own account in equity securities listed on a national exchange and while both types of institutions would be able to take advantage of a limited "leeway" investment

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provision, deposit thrift institutions would apparently have fewer restrictions than commercial banks on the use of such an investment power. Deposit thrift institutions, on the other hand, would be subject to a 10 percent of assets limitation on secured and unsecured consumer loans, whereas no similar limitation would apply to commercial banks. With such obvious differences, the Commission must have meant to say it was seeking to achieve substantial, not exact, equality among competitors in the same market. Only the collective judgments of individual institutions are likely to determine whether the Commission achieved even this more limited goal.

The Conference of State Bank Supervisors has quite properly been concerned over the years with questions of "competitive equality" between banks under national charter and banks under State charter. The Hunt Commission addressed itself, however, to only a few of the issues presented to it by your Conference report on regulatory structure. I regret particularly that the Commission failed to suggest changes which would deal with the single most pressing problem today for the dual banking system -- namely the differing results being reached for national and State banks under the federal Bank Merger Act. The Commission proposed instead that the divided administration of the Act be continued, despite evidence being accumulated under the Bank Holding Company Act and the Truth in Lending Act that a more unified approach can be found which will still preserve the basic advantages of a dual banking system. Hopefully, Congress will reopen this subject, as well as others contained in your report, so that its own intentions as to the future of the dual banking system will be clarified. You would agree, I am sure, that differences in competitive opportunity based on charter run directly counter to the notion of competitive equality for all institutions operating in the same market.

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Along these same lines, the Commission has made a series of related recommendations that could well lead to competition on an unequal basis in the same market and to aggravating at the same time existing points of irritation within the dual banking system. I am referring to the proposal under which the National Bank Administrator, the Administrator of State Banks or individual State supervisors or both (the Report is unclear) and the Federal Home Loan Bank Board separately would be able to decide for the institutions under their jurisdiction which of the financially related activities now being authorized by the Federal Reserve Board for bank holding companies could be exercised by such institutions directly or through subsidiaries. While the recommendation raises serious problems of additional risk for deposit institutions, as distinct from risks isolated in a parent holding company, my point in mentioning the matter today is to emphasize the possibility -- perhaps even the probability -- that the different supervisory agencies will come up with different results for different sets of institutions. For mutual savings banks and savings and loan associations, this will be inevitable in any event as the Commission itself is recommending that such activities be extended to them only if limited to services for individuals and non-business entities. Other differences, in my judgment, are bound to occur as different people wrestle in the agencies with the same complex issues which have preoccupied the Federal Reserve Board insofar as bank holding companies are concerned. One has only to review the steadily-increasing list of activities being authorized for bank holding companies to realize how basic to an institution's competitive position in its market will be the agency determinations proposed by the Commission.

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If one agrees with the Commission's premise that bank holding companies should not be the only vehicle through which such services may be extended to the public, there would seem to be at least two procedures by which competitive equality for different types of institutions can be assured in this area of financially-related services: (1) the Federal Reserve Board itself could be assigned the job of determining which of the related activities being authorized for bank holding companies may properly be conducted by supervised institutions directly or through subsidiaries, and under what conditions; or (2) Congress could enact a "positive" laundry list of related activities authorized to be performed directly by supervised institutions, prescribing any necessary conditions by statute, and supplementing the provisions periodically. The first alternative has obvious advantages in terms of flexibility and is the only one of the two that assures that the same criteria will be applied in determining the direct activities to be authorized as the Federal Reserve Board is now applying in developing the holding company list. The important point, whatever the procedure, is that the results produce substantial equality, not inequality, for competitors in the same market. Congress rejected proposals for dividing the administration of the 1970 amendments to the Bank Holding Company Act, as you know. It is to be hoped that it will adhere to that determination here, assuming of course, that Congress agrees with the Commission's basic premise that the form of organization should not control the ability to offer financially-related services.

Competitive equality in the same market was undoubtedly a major factor in the Commission's recommendation that all commercial banks, and all deposit thrift institutions offering third party payments, be required to keep uniform

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reserves on their demand deposits in accordance with Federal Reserve requirements. The Commission made a passing reference to the possible effect this extension might have on improving the Federal Reserve's ability to manage the money supply, but there are significant economic arguments to the effect that the Fed's control over monetary policy has not been adversely affected -- up to this point in time -- by the volume of commercial bank assets outside the System. Continued attrition in the number of assets of member banks may, of course, trigger such an adverse effect in the future but it does not seem to have happened so far. If competitive equality is the key to the Commission's recommendation on mandatory Federal Reserve membership, I suspect much more remains to be said about the matter before such a drastic break is made with our long tradition of voluntary membership -- a break that would almost certainly produce a sharp decline in the earnings of most non-member banks.

One of the questions raised by this Commission recommendation, as well as by others, is whether or not it is completely realistic to assume competitive equality in the same market when legal powers and obligations are the same but the institutions involved are of substantially different size. Based on recent and continuing FDIC research, I am not one who believes that the small bank operates at a great disadvantage in cost when it comes to such typical bank functions as demand deposits, savings deposits, installment loans, securities investments, real estate loans or business loans, although some slight economies of scale may exist in some of these categories. But I do believe that larger banks have a greater capacity to diversify the range of their services through their superior ability to raise capital, to attract a specialized management and to advertise for business. For similar reasons, most commentators have concluded that the larger institutions in a given

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market are those most likely to be able to take advantage of the new powers being proposed by the Commission for commercial banks, mutual savings banks and savings and loan associations. If so, some compensating adjustment in earnings potential may be necessary to enable smaller institutions in the same market to compete on a substantially equal basis with larger banks or thrift institutions -- an adjustment that might take the form of a conscious decision not to impose the same reserve requirements on small institutions that are imposed on their larger competitors.

The Hunt Commission has suggested basic and long-range changes in the financial structure of the country, keyed to the concept of substantial equality for all institutions competing in the same market. Its package of recommendations, some of which are admittedly controversial, will undoubtedly be modified in the legislative process, and that presents to each of us both the opportunity and the obligation to contribute constructively to the review now being made by the Administration and, thereafter, to the review which will be made in Congress. The end result can be much greater flexibility for all financial institutions, a system in which the public benefits from increased competition, and a structure in which the dual banking system receives new vitality. We should work together to make it so.

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