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THE BANKING CHALLENGES OF THE MID-SEVENTIES

Remarks of

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The Banking Challenges of the Mid-Seventies

It may be presumptuous of me to begin your convention with a series of challenges to you to meet over the coming years. After all, my background is that of a regulator. But perhaps it is that background which enables me to oversee some of the problems of commercial banking, and the challenges toward which bankers should reach for solutions over the coming years. It seems to me that the challenges facing the banking industry today lie both in internal and external areas with which bankers must engage. Thus, bankers must meet their internal bank problems and the challenges from the external environment.

First in my view, banking must set its objectives. Now I do not mean to belabor you with a "management by objectives" lecture, but banking does not appear to have established its objectives either in the clarity with which they should be expressed or in the relative priorities which need expression. It seems to me that banking must decide whether asset growth, service to the community, or bottom-line expansion, is to be the primary objective. Now I know that most of you would promptly answer that you want to serve your community, you want to make good loans to people and businesses with good credit ratings, and bring back a profit for your bank. But too many times over the

past few years it seemed as though banking's objective was growth for growth's sake rather than growth for service to its community. So it seems to me that the bankers of today need to set forth with a great deal of clarity the primary and overriding objectives of your bank.

After such an exercise, and I don't mean it to be just a game in which you write these objectives and then lay them aside, but after you have established them clearly in your mind, it seems to me your next step needs to be to settle the structure of your bank to meet these objectives. Such a structural discussion could, of course, range from the normal structural analysis of unit versus branching and holding company approaches to a discussion of internal structure within the bank to assure yourselves that your banks are organized in a fashion to yield your objectives. Structural analysis should also include the desirable areas of concentration and the provision of funds and personnel to those areas. Structural analysis could appraise your bank's organizational posture and position in the community against your competition, whether bank or nonbank, and where that competition is doing a better or a poorer job than your bank. Such competitive analysis could also include the appraisal of personnel management, compensation, fringe benefits, and other elements which yield the total of the ability of the competitor to meet or exceed your own service to the community.

Planning ahead to meet the competition on his own grounds and where possible to exceed him in meeting your objectives can be a worthwhile exercise.

Assuming that you have completed your objectives, structural and competitive analyses, it is then time to look internally and see if you have the management necessary to do the job. Self analysis on management is difficult. But those of you growing up in the ranks of banks must be able to look around and see the areas in which management is deficient. When you become the chief executive officers, I hope you will devote considerable attention to the development of management, to broadening of its scope and horizons, and to the need for well-trained managers in the future banking world.

As we then go on in the internal development of the bank, it seems to me your next step needs to be an appraisal of the sources of funds available to your bank--the types of funds you are willing to accept and those about which you have reservations or ultimately are unwilling to accept. Such "source of funds" analysis ought to not only include the type of funds but the source from which those individual types of funds are drawn. You should make sure that a careful appraisal is made of the customer-oriented funds and those with which you are reasonably comfortable in the expectation that they will remain with your bank as opposed to those which appear to have the characteristics of volatility for small margins of interest.

Developing these sources of funds then provides a base from which you can develop your credit commitments primarily of course to the local borrowers and, if you are large enough, to regional customers. Ultimately, you may wish to plan for a limited national credit demand if your bank has grown to that extent. But your credit commitments should always be tied to a firm foundation of available funds. Excesses in commitments can lead a bank down a primrose path requiring it to reach for highly volatile funds.

Simultaneously, our banker of tomorrow must look with great care at the capital and liquidity of his bank. Capital adequacy is a matter which has drawn a great deal of attention over the past few years and is likely to draw even more as the banks reappraise their need for capital and as the regulators reappraise their requirements for capital. Similarly, "liquidity analysis" makes good sense in today's banking and provides the means by which a banker can avoid the liquidity traps so evident in 1974.

Our banker of tomorrow must then look with care as to the growth of his bank and the adequacy of controls with which he can measure that growth and measure the efficiency and effectiveness of his back office operations. It makes little sense to build a bank without back office protection, both for security and efficiency. If indeed the banker of tomorrow must face a growing challenge

to handle more and more credits through loans, checks, wire transfers, and cash flows, it makes great sense to devise back office operational arrangements which can handle a steadily growing volume with greater effectiveness and efficiency.

Some of you have or will become involved in banks who have made the step into multi-bank holding companies. To you there are special challenges for the 1970's because we have already seen some of the problems developing out of overeagerness to grow by reaching for new markets or market penetration by acquisitions. Similarly, we have seen rather sizable problems develop from the acquisition of nonbank companies where experienced management was lacking in the handling of an unfamiliar business. To you then the challenge is to ensure your handling of the holding company so that it reinforces the strengths of the bank and nonbank subsidiaries and so that it can handle through adequate management and informational procedures a warning system which will alert management to problems developing downstream. There is little doubt that the effectiveness by which you accomplish this job will have a great effect upon the future of multi-bank holding companies in the United States.

Of course, all of you have a responsibility for public service--public service to your community, to your region, and to your State. A public service which has to be reckoned in the form of time and leadership and even money to provide the base for adequate

growth. And yet your attention needs to be directed also to the efficient handling of local and State governmental units as well as private nonfinancial, nonpolitical, and nonprofit organizations. It is as true today as it has been for years that the banker should be a leader in the community. The communities which have made the greatest progress appear to be those where the banks take the greatest interest in the future of their community.

But the public service requirements and the economic statesmanship responsibilities of banking extend beyond the borders of your own city or your own State. They move to Washington and to the national interest and in this field bankers should act as a banking industry. Here the political base and the strength of that base are a prime requirement and yet to a considerable extent the bankers of today have fallen short of the strength of political wisdom and participation that could have warded off some of the more difficult and trying legislative crises for banking over the past decade. It will be a major challenge to you in this room to so mobilize yourselves and your associates in the banking industry so that your strengths of leadership in the local and State environment can be translated into strengths at the congressional level of Government. If such strengths can be achieved, then banking can have a strong place in all of the economic and financial legislation of Government.

You should be expressing a strong voice on many current matters--matters such as the question of regulatory reform--whether there should be a single Federal banking regulator, or retention of the present form of regulation, or a reassignment of responsibilities between regulators? Your voice in supporting regulatory improvements is badly needed, but it needs to come as one voice, not a fragmented voice which purports to represent a part of banking and then have another part take the opposite side. The examination, regulatory, supervisory, and enforcement activity by the principal bank regulators does need improvement. It needs improvement to make sure that the future of banking in this country is a safe, sound and progressive industry. You as the bankers of the future should have a position from which you can support the proper monetary and fiscal policies of Government. On the monetary policy side we need your voice--a voice which speaks strongly to the leaders of Congress. A voice which says, if you believe it, that the nation's central bank should be an independent organization, to exercise its judgment to counter those excesses of Government elsewhere, to restrain credit when necessary, to supply the credit needs of the nation. We need your voice to say, if you believe it, that the intrusions of Government, particularly of Congress, into the policy-making roles of the central bank may prove to be a most expensive experiment. If Congress, through its banking committees, is to direct the policies

of the Federal Reserve, obviously the responsibility for those policies passes to Congress. We are only at the threshold of the the start of such a committee activity but you bankers should have a keen interest and a strong voice in the future of this activity.

Similarly, I would hope that you in this room will work toward the solution of the problem of Federal Reserve membership. It is no secret for many of you that there are inequities of burden in reserve maintenance between member and nonmember banks. It makes little sense to me that a national policy for the benefit of all is to be effected through only a limited number of banks. It seems to me that a national policy should impact on all members of the financial community. Now I recognize that you and many others believe that the dual banking system requires choice of membership. But the choice given you last year in the form of universal requirements did not substantively challenge the dual banking system. It still permits State chartering, State supervision, and State examination of State banks. Now you may say that I am merely quibbling on the outside fringes because the burden of Reserve membership is a primary reason for withdrawal. But I would say that if this nation is to sustain a strong central bank which can provide an independent and strong monetary policy, we are going to have to have the support of the whole banking community--not just a part of it. In numbers,

you represent probably a large share of State nonmember banks. Your reserve maintenance is clearly less onerous than that of the members of the Federal Reserve, and yet, you take unto yourselves the benefits and the improvements which are created by the nation's central bank. I can not shame you into joining the Federal Reserve and don't wish to try to. But I hope that you and your friends will think carefully on this matter and see whether there is an acceptable method by which the central bank can achieve its primary objectives and that you can contribute along with the members of the System to fewer inequities and fewer differences in service.

Finally, in my opinion, the bankers of the United States need to band together in a strong voice for the protection of the fiscal system of this nation. It seems as though we never learn. We come back time and time again to deficit spending of a steadily larger amount for every cyclical downturn. Regardless of the merits of the case in this particular situation, it is rather clear that our Congress seems to think it is responding to the will of the majority of the people when it attempts to spend its way out of every major problem. And Congress is willing to accept new responsibilities and problems. You and I and the rest of the people in the nation need to examine this procedure of forwarding our problems to the Federal Government. If we send our problems there, and demand the funds to meet those problems, the power and the authority will go with the funding.

If we want to maintain local control, then we must make our voice heard throughout the land and, more particularly, in the halls of Congress--that fiscal excesses, continually increasing Federal programs, and higher and higher expenditures, are not--I repeat not--a guarantee of reelection. If this message can be transmitted through you--the leaders of the communities--I believe we can get a response in Congress.

Thus, you who are the future of banking have a number of very important jobs to do. I have not touched upon your international responsibilities, your need to express a strong stand on trade and isolationist barriers, to express your voice on the development of an international monetary control system, or to control your own activities internationally. But there are so many problems today that I thought I would bring to you those that are on my mind at the moment. I wish you luck in the future and look forward to your voices being added to the management strength of this great banking industry. Thank you.

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