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COORDINATION AND SUBSTANCE OF BANK REGULATION

Remarks of

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at the

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COORDINATION AND SUBSTANCE OF BANK REGULATION

In the past year, proposals to reappraise the Federal bank regulatory structure have surfaced once again. Public interest in regulatory effectiveness has been precipitated by two of the largest bank failures in the nation's history and the ensuing apprehension concerning the strength of the nation's banking system. An apprehension, I hasten to add, I do not share. No doubt, all of you are aware that recommendations for the unification or realignment of Federal bank supervisory authority have recently been voiced by some of my colleagues on the Board, other regulatory officials, members of Congress and others. Similar suggestions have been made before, almost from the earliest days of the Federal Government's overlapping system of bank supervision.

Without question there are some changes which would eliminate redundancies and uncertainties existing in our Federal bank regulatory framework. On the other hand, I believe few appreciate the degree of supervisory perception of banking problems and the extent of agency coordination in dealing with them that now exists. In any event, I am not here today to add further fuel to the already overheated issue of regulatory structure, but rather to focus attention on the substance of supervisory responsibility and effectiveness. We are in danger of giving too much attention to who regulates and too little to what aspects of banking need regulation and how that regulation should be effected. Since the question of who regulates will not go away

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regardless of its relative lesser importance, I have an alternative suggestion for reducing inconsistency in supervisory actions with numerous precedents to support it.

That alternative, which I would describe as the "harmonization" of State and Federal regulatory standards and practices, would call for a far more energetic program than we have yet witnessed to align more closely the regulatory policies embodied in both State and Federal laws and official actions. The regulatory apparatuses of over 50 jurisdictions or authorities have created many diversities in regulatory standards and practices--far more, in my opinion, than can be justified in the interest of public policy or as a manifestation of environmental differences.

Interestingly, or perhaps ironically, almost precisely ten years ago today, in remarks to a group of Illinois bankers, I expressed much the same view as to the public inconvenience and economic loss arising from the differences among the State and Federal banking systems in the United States. Conditions have certainly improved since that time, but more movement toward nationwide regulatory standards is needed and could be achieved following precedents in other areas and using, for example, the offices of the National Conference of Commissioners on Uniform State Laws.

A coordination program analogous to that I am recommending is currently being undertaken among the member nations of the European Economic Community. As in this country, banking emergencies which have

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had repercussions throughout the European Community have inspired a call for greater cooperation among supervisory agencies. The present European efforts are primarily focused on coordinating legislation relating to banking supervision aimed at protecting bank depositors against risk of loss. This legislation covers, in part, rules relating to authorization of new credit institutions and branches, capital, and other security provisions. The goal of these efforts is the creation of a common market for credit institutions.

In our country, we have precedents in the Uniform Commercial Code, and other uniform acts and models which cover a wide range of subjects. A uniform banking code which contained provisions dealing with major aspects of bank regulation would not need to establish complete uniformity in standards for all aspects of commercial bank operations. State banking departments in some areas of the country may never encounter the problems faced by authorities in other States. This, of course, does not mean that certain minimum standards and procedures for examination and supervision cannot be identified and agreed upon.

If some action toward "harmonization" is not taken, it seems obvious to me that, looking ahead, failure to reduce the existing variation in both the standards of regulation and the effectiveness with which they are maintained will serve to strengthen the case for those who believe that all aspects of commercial bank operations must be placed under one central authority responsible for protecting the public interest.

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Turning now to the substance of "harmonization," I believe we should be concerned with greater uniformity in the regulatory standards in three areas: (1) bank structure, (2) bank operating practices, and (3) the scope of bank activities.

Bank structure standards have to do with constraints on the location of branches and other facilities for customers' access to their banks' services such as loan production offices, foreign branches and agencies, offices of affiliated enterprises, automated teller facilities and POS (point-of-sale) electronic terminals.

Regulatory surveillance over bank operating practices has to do with capital and liquidity requirements, interest rate ceilings, limitations on loans to single borrowing interests, transfers among affiliates, the holding of cash reserves and usury statutes.

Scope of banking activities has to do with the range of activities in which banks, bank holding companies and their affiliates are empowered to engage both here and abroad.

I have a few brief comments about regulatory problems in each of these areas beginning with those relating to the scope of banking operations.

Probably the most significant development in recent years affecting the scope of banking services was the adoption of the 1970 Amendments to the Bank Holding Company Act. Under these amendments many banking organizations have initiated a number of bank-related financial activities on a multi-State and even international scale.

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This extension, both geographically and functionally, of banking powers has been accomplished in an orderly, deliberate fashion. Some approvals of new activities are in litigation; others, such as travel agency powers and the right to acquire savings and loan associations, have not been finally resolved. A large number of banks have acquired leasing, consumer finance or mortgage companies. In my opinion, only time and study will determine whether bank-related REITs, mortgage finance, factoring and leasing companies have turned out to give superior performance and stability over their non-bank counterparts. For those U.S. banks having foreign operations, an important issue relating to the range of their powers is whether in certain host countries their activities should conform to those authorized for local banks or, in the alternative, should U.S. banks be limited in any host country to the banking and financial powers they may exercise in the U.S.

The old banking maxim that banks should not compete with their customers has been somewhat breached by extension of financial services under the Holding Company Act but probably not unjustifiably so considering that some of banking's customers have been poaching in no small way on the banking business.

Turning to another phase of regulatory concern--constraints on banking operations--we come into an area that fairly bristles with controversial issues, some old, some new. Asset quality and capital adequacy are continuing problems; the latter is particularly intractable.

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More recently, bank liquidity has emerged as a matter of regulatory concern as money markets have shown a tendency to become standoffish and acutely quality conscious just at the time their liquidity function is indispensable to the very premise of a liability management policy.

Other regulatory concerns are being generated by changes in the U.S. and world economy; the increased visibility of banking policies affecting the public has brought to the fore numerous disclosure issues. For those U.S. banks who have extended their operations worldwide, exposure to foreign exchange risks and foreign financial affiliations have created new dimensions of regulatory concern.

If these phases of regulation having to do with examination and close surveillance of banking operations are viewed from a distance--say, by a European regulator--he is likely to suggest that U.S. regulation is redundant and costly. While I have yet to encounter this reaction among U.S. regulators, the idea may be worth exploration. Using ballpark numbers we are spending (including indirect as well as direct costs) about $200 million to make reasonably fail-safe some $1,000 billion in deposits and other claims, including in a sense the investment stockholders whose interest cannot be disassociated from this system of surveillance. Two hundred million dollars is not much relative to total assets, or even in relation to the $70 billion of gross income the banking system generated in 1974. It begins to get meaningful when compared to the industry's $7 billion net income last year, particularly since the banking industry in one way or another pays most of the $200 million.

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The final point I want to mention is also an old and sensitive topic for many bankers and regulators--banking structure and competition. While State and Federally imposed limitations on the geographic expansion of bank facilities and services continue to exist, it is clear that present-day financial services are being offered on a regional, national and international basis. In many respects, a nationwide banking service is a reality in this country in spite of the State and Federal limitations on the spread of banking facilities. As bankers operating in the shadow of two of the nation's largest financial centers, you are keenly aware of the interchange of financial services across State lines and how that fact has truncated and stunted New Jersey's banking structure.

The public, of course, is not restricted in its choice of a financial or banking institution by the political boundary lines, either intra- or inter-State. Proximity and convenience are becoming less and less a constraint on the extension of depository markets. Regulatory constraints on a freely competitive banking structure have their roots in the fear of competition--fear of competition from other banks, from thrift institutions, from the money market and the Treasury, all of whom compete for the same sources of funds. A banker would be foolish to ignore such competition but he cannot in any realistic sense expect that regulatory actions can, in the long run, throttle it. In today's and tomorrow's world, insulation from competition for funds is an illusion. Communication links are providing universal

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access to all markets and unless the banker is to become a technological casualty, as have the village blacksmith and the locomotive fireman, he must take the steps needed to meet that competition.

The communication links breaking down local and regional markets are to be found in the rapidly developing technology which is enabling financial institutions and non-bank data processors to offer electronic funds transfer services of ever-increasing sophistication. While these developments will be the subject of study by the National Commission on Electronic Fund Transfers created by Congress, development and experimentation in the handling of payments information by non-bank and unregulated enterprises are not being held back until completion of the Commission's deliberations but are proceeding apace. At the present time, many State legislatures and bank supervisory authorities are attempting to put in place standards for the operation of various types of off-site automatic machines and point-of-sale facilities. These efforts are, in part, aimed at providing equitable operational standards for State-chartered institutions should the Comptroller's interpretation permitting national banks nationwide use of off-site facilities survive the test of judicial and legislative review.

It is impossible at this time to accurately determine how EFT will alter the banking structure and depository institutions generally, since right now its full capability cannot be gauged. What may be necessary, however is the identification of operational

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standards that will serve as trail blazes, rather than obstructions, to the future development of these facilities. Current limitations, such as State branching restrictions, if applied to off-site POS facilities will, without doubt, serve to impede banking development and leave open the opportunity for exploitation to non-bank depository institutions or even to unregulated non-financial enterprises.

Bank regulation is a well-seasoned topic for both bankers and regulators. Its periodical appearance at meetings such as we are having today is enhanced by the variegation of industry interests and regulatory reaction to them. Even the old issues can often take on a new coloration. A dialogue among us is in keeping with the times and the complexity of the problems we face, but I think we should also remind ourselves that the resolution of some of these problems can be too long postponed.

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