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Remarks of J. L. Robertson

Vice Chairman of the Board of Governors
of the
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before the

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Time for Reform

A month ago, in a speech in Phoenix, I tried to emphasize the need for common effort by government officials, businessmen, bankers, labor leaders, and consumers, if we are to win the battle against inflation. I referred to the need to conform our actions to the public welfare, and argued that this entails adhering to the spirit as well as the letter of the law. For examples of what I was talking about, I could hardly look outside my own field without being charged with hypocrisy (ample though examples are elsewhere), so I pointed to some of the ways that commercial banks have endeavored to make end-runs around Federal Reserve regulations and thereby thwart and delay the effectiveness of our efforts to curtail the amount of money and bank credit chasing after goods and services, pushing prices higher and higher.

Well, I soon learned that I had stumbled into a den of lions. I was accused of being irresponsible, of seeking publicity, and of trying to encourage Congress to enact restrictive legislation. After the first avalanche of complaints, I recalled that Daniel once entered a similar den and survived; if he could, perhaps a man from Broken Bow, Nebraska, could too - even though, in my case, there was little chance of having the help of an angel. With my courage thus partially restored, I decided to step forward again tonight, this time with the explicit purpose of pushing a little further some ideas for reform that I launched several years ago and which are now gaining a few adherents here and there. Once again, I may be stepping into a den of lions, but I hope you will hear me out before launching an attack.

A story told to me by an old friend in Broken Bow, a history buff, may help persuade you to delay that long, at least. He said that many years ago a French Count, leading his troops in battle, was captured and taken to the tent of the General of the opposing army, where he was interrogated. Finally, the General asked for information about the deployment of his forces. The Count reared back, and said: "That I will never tell. I am a nobleman. I will not betray my country." The General was not to be trifled

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with, and angrily directed that he be taken to the block. The Count was led away and his head placed on the block. The hatchetman raised his axe high overhead and started the down-swing. At that precise moment, the Count waved a hand and cried, "Wait! Wait! I'll talk!" But the axe fell, beheading him. My friend said the moral was obvious: "Don't hatchet your Counts before they chicken."

You can see that it is with considerable trepidation that I seek your support of two goals for all major depositary institutions in the 1970's - goals which ultimately, directly or indirectly, affect every commercial bank, mutual savings bank, and savings and loan association in the nation.

First, all of our 500 or so mutual savings banks and all of our 5,900 savings and loan associations should be permitted - at their option - to become broad-scale lenders and borrowers along the pattern of commercial banks. In the gradual process of conversion, these institutions would be expected to take on reserve requirements, tax status, supervisory safeguards, and other responsibilities similar to those now applicable to commercial banks.

Second, all federal supervision of bank-type institutions should be consolidated in one independent agency. This responsibility is now parcelled out among four separate agencies - the Federal Reserve Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board.

Both goals, in my opinion, represent high priority reforms in the financial area. In lieu of the present hodgepodge of federal supervision, we need a common and consistent set of ground rules. These changes toward uniformity, I am convinced, are essential steps in bolstering the ability of our financial system to serve the changing credit and savings requirements of our expanding economy in the decades ahead.

The two goals are not novel. In 1966, I suggested that insofar as federal law is concerned, the powers and

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duties of all commercial banks, mutual savings banks, and savings and loan associations, should be equalized. As long ago as 1962, I urged that all federal supervision of banking should be placed in a single banking agency - an idea, incidentally, that dates back at least five decades.

To speak candidly, in the spirit of Truth in Lending, I concede that neither proposal received universal acceptance at the time that it was originally marketed. Since then, however, consumer resistance has shown signs of fading. Recognition of the need for change has spread among both the regulators and the regulated.

Only recently, the President re-emphasized the importance of these two aspects of our financial system by establishing a new commission whose primary purpose is to ascertain needed changes in our financial institutions and their regulatory structure. I submit that among the changes which are most needed now at the federal level is uniformity of treatment for all federally insured institutions.

Why Change Is Needed

The logic seems clear why such changes should be the order of the day, within the context of a dual federal-state system.

First, uniformity would simplify - and thus enhance the functioning of - our complex financial system. We need the strongest possible economy if our nation is to continue to lead the free world while maintaining maximum scope for employment, income, and growth at home. One important underpinning for such an economy is a smoothly operating system of depositary institutions. This implies the absence of unnecessary constraints that can impede the vital process of gathering savings and allocating credit in open and competitive markets.

Unfortunately, such constraints are all too possible now at the federal level. There are differing statutes and regulations affecting different types of banks. There are

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also differing controls affecting different types of institutions, such as commercial banks, savings banks, and S & Ls. We have, in practice, a jumble of ad hoc arrangements that makes for incompatibility, controversy, inefficiency, and competitive inequality. To correct the situation and provide a uniform basis for serving the public, these institutions should all be allowed by federal law to engage in a wide range of activities - including, of course, the acceptance of demand deposits as well as time and savings deposits.

Uniformity in the structure and regulation of these institutions at the federal level would, as I see it, place all competition for the public's business squarely where it belongs - on as close to the same footing as possible. It would allow them to devote all their time to serving the public with utmost efficiency. Today, in contrast, too much time is spent in efforts to protect special interests or encroach on preserves traditionally reserved for others.

Given a common set of ground rules, I am confident that all these institutions would have greater opportunity than ever to innovate. Without the constraints that now prevail on the rates or the types of instruments that can be offered to attract additional savings, they could - for example - compete more flexibly with the securities market for consumer and business savings. In finding ways to do so, they could penetrate the market for savings more broadly and effectively than has been possible so far.

The need for innovation in our financial markets seems certain to intensify during the 1970's. New forms of credit demands will inevitably arise with increasing emphasis on environmental improvements, more efficient international markets, better neighborhoods, and many other facets of our economic and social well-being. The sheer amount of financing that will be required to accommodate our expanding economy will be enormous. Based even on a conservative projection, our economy appears likely to expand over the next ten years by as much in physical terms as it did in the past twenty.

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Uniformity in the structure and regulation of bank-type institutions at the federal level would bring other benefits, too. It would strengthen the hand of the public in formulating and implementing stabilization policies that would be more uniformly applicable. Problems of controlling the expansion of credit, for instance, would be simplified if all depositary lenders, with expanded authority to accept deposits and to serve the public's credit needs, were also subject to similar reserve requirements. More direct influence over the assets and liabilities held by the financial system would accordingly be possible for the monetary authorities. More equitable treatment of all depositary institutions could be achieved.

At the same time, uniform powers and duties would allow any of these lenders to serve particular sectors of the credit markets. Benefits of scale in operations as well as other economies of specialization could continue to be realized by institutions that chose to focus on particular types of local, regional, or national credit demands. But such specialization would not be required. Nor would it be necessary for an institution to continue to specialize in a particular sector if other credit demands became more pressing.

Another advantage of this approach, as I see it, is that it would lay the groundwork for more direct thrust of public policy on sectors of the credit markets deemed to be of the most urgent social priority. Suppose housing, to take a very realistic example, was placed high on the priority list. In that case, incentives of an across-the-board nature could be devised in order to encourage all major types of depositary institutions to direct more of their resources into that special area. This would allow maximum response by all of them to the opportunities for both profit and service.

Today, in contrast, our markets are all too fragmented in terms of varying - and sometimes even conflicting - special interests, benefits, and support programs applicable to particular types of financial institutions. This makes for difficulty - if not downright confusion - in developing and administering appropriate overall public policy. It also makes for obscurity in measuring the net benefits that may result.

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A direct frontal approach to these problems would tend to unify rather than fragment the savings and credit markets. Uniformity in powers and duties - including equality with respect to special incentives for investment in high-priority sectors - could virtually eliminate the burden on the government of supporting and protecting specialized institutions established solely to serve particular areas of the credit markets. It would help bring to light social benefits that might flow from incentives made available across the board.

Finally, I foresee that uniformity would at long last assure equity in the federal government's treatment of all such institutions. That would reduce incentives for unseemly competitive struggles among the federal regulators. All too often such internecine warfare leads to competitive laxity in chartering, regulating and supervising such institutions. It also makes for wasteful duplication and for time-consuming - and, all too often, fruitless - efforts to harmonize conflicting views of federal supervisors. Divided authority in this field, I am convinced, is more than an anachronism. It is a burdensome albatross for any financial system where competition should be based on serving the public rather than on serving oneself.

Incidentally, I see no insurmountable theoretical or supervisory barriers to rule out commercial bank operations conducted by mutual institutions. Some special safeguards might have to be devised in order to compensate for the absence of a cushion of protection that is ordinarily furnished by capital stock, but there is no reason why this could not be done by suitable reserve requirements and liquidity ratios.

Changes under Way

The logic underlying the need for the changes which I have proposed, and their inevitability, has recently been reinforced by the sweep of events in the market place. Let me cite examples.

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First, commercial banks in several ways have become more like S & Ls and savings banks during recent years. They have been competing vigorously in savings and mortgage-loan markets formerly dominated by the thrift institutions. From 1965 through 1969, in fact, commercial banks experienced a larger growth in the dollar volume of their consumer-type savings liabilities than all S & Ls and all mutual savings banks combined. They also stepped up their propensity to invest this type of savings inflow in mortgages.

Second, savings banks and S & Ls, partly as a defensive reaction, have become more like commercial banks in the ways they compete for savings. Only quite recently, federal savings and loan associations were authorized for the first time to accept savings "deposits" as well as savings "shares". Today, S & Ls can offer virtually the same line of savings instruments as the banks, including, to some extent, certificates in denominations of $100,000 and over.

Third, some savings banks and S & Ls are beginning to provide the convenience of one-stop service for their customers. Several states have authorized mutual savings banks to offer checking accounts. Also, Congress recently authorized the Federal Home Loan Bank Board to permit S & Ls to offer bill-paying services for their savers.

Fourth, savings banks and S & Ls have become more like commercial banks in the kinds of loans and investments they are authorized to make. A tally of legislative changes affecting the savings bank industry during the past year alone filled four pages of a recent issue of the Savings Bank Journal. In an effort to capitalize on these and other developments, a number of savings and loan associations have recently merged with savings banks or commercial banks.

Despite the changes that have drawn all types of depositary institutions closer to the same mold, demands have continued for special privileges and protection for some groups. Such demands have been reflected in the

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higher interest rate ceilings that still prevail for consumer-type deposits at savings and loan associations and at savings banks compared to those at commercial banks. Of course, if we achieve both of the goals I have outlined, and all three types of institutions begin to compete on an equal basis in virtually the same market for consumer savings, it is possible that Regulation Q ceilings would no longer be necessary. On grounds of equity, the current interest rate ceilings are objectionable because they discriminate against small savers. Moreover, while the ceilings limit the price that depositary institutions can pay for savings, those institutions are free to relend the funds at whatever price the market will bear.

As a practical matter, experience with interest rate ceilings over the past four years has demonstrated the limited usefulness of this stop-gap arrangement - even though that arrangement was indispensable in the circumstances prevailing during those years. While the ceilings have protected thrift institutions against the inroads of inter-group competition, they have not shown any marked success in channeling savings flows to depositary lenders against the pull of forces operating in securities markets where price competition remains strong. Over the three year period ending in 1968, for example, households placed an annual average of $22 billion more in savings accounts at banks and savings and loan associations than they invested directly in the stock and bond market. During 1969, in contrast, exactly the opposite pattern emerged. In that year, households put $6 billion more into stocks and bonds than they did into savings accounts.

Against the background of recent developments, pressures have continued both for still broader lending and investment powers of savings and loan associations and savings banks and for more protective measures. Additional states, as you know, are being asked to authorize unlimited checking accounts in mutual savings banks. Two recent studies of the S & L industry - as well as one by a blue-ribbon industry advisory committee - have recommended limited checking account privileges for savings and loan associations.

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These and other pressures, in my opinion, merely emphasize that the time is ripe for reform of our federal laws and policies so as to permit savings banks and S & Ls to find their own way in the financial world unhampered by arbitrary constraints. Now is the time to authorize these institutions to begin to evolve gradually toward the widest possible flexibility in borrowing, lending, and investment powers that is consistent with their broadened responsibilities - that is to say, permit them to perform like commercial banks, even though they continue to be mutual institutions.

Failure to allow our thrift institutions to become integral and uniform parts of our general financial system is bound to perpetuate the risk of inefficiencies, or worse, that come from overspecialization in some areas and underspecialization in others. That course of action - or inaction - is certain to reinforce demands to meet newly-emerging credit needs by creating new institutions, with additional special powers, calling for further protective measures to insulate them from the mainstream of competition. It is sure to continue the tradition of shoddy patchwork rather than raise the prospect of lasting improvement.

I have detailed on other occasions some of the conflicts that seem inherent in this unfortunate situation. I have also pointed out the uncertainties that such a division of authority at the federal level can create by resulting in different sets of ground rules, under which different classes of financial institutions strive to serve more or less the same public. I have indicated how unification of federal bank supervisory agencies could and should be achieved under a new agency of government.

As you know, I have called for a Federal Banking Commission to be headed by five Commissioners, to be appointed by the President, with the advice and consent of the Senate. The Commission would have transferred to it all supervisory powers now exercised by the Federal Reserve Board and the Comptroller of the Currency, and all

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powers and functions now vested in the Federal Deposit Insurance Corporation. For the reasons I have suggested today, I believe the idea of the Federal Banking Commission should be expanded in the '70s to include the supervisory powers now exercised by the Federal Home Loan Bank Board.

A Gradual Transition

In looking to the future of our financial system, it is often fruitful to recall the experience of earlier times. The English clergyman and historian, Thomas Fuller, wrote this in his Worthies of England, some two centuries ago: "Let him who would be happy for a day, go to the barber; for a week, marry a wife; for a month, buy him a horse; for a year, build him a new house; for all his lifetime, be an honest man."

Following this advice, I should hasten to say, in all honesty, that I do not necessarily subscribe to all of the Reverend Fuller's recommendations. Nor does the Board of Governors of the Federal Reserve System necessarily endorse the proposals that I have outlined; they are offered here solely on my own initiative.

The effort to live up to Fuller's recipe for lifetime happiness, however, compels me to point out that the reforms that I have proposed would obviously entail far-reaching alterations of our present system of depositary institutions. They could ultimately affect 6,400 savings and loan associations and savings banks with 5,000 branches and assets of some $240 billion. Measured in these terms, S & Ls and savings banks together are now two-fifths as numerous as commercial banks. They have a fourth as many branches. Their assets amount to nearly half of the commercial bank total.

Uniformity in the structure and supervision of all these institutions as lenders, borrowers, and investors would require extensive legislation by the Congress. It would mean a drastic reorganization of federal supervisory agencies in order to consolidate all responsibility where I believe it rightly should be - in one independent agency.

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Although certainly not insuperable, these tasks are indeed formidable. And anyone who has been observing Washington from the inside as long as I have knows that changes of this magnitude in our financial structure and its supervision will be a slow evolutionary process. That is exactly the reason why that process should begin now.

The present time is none too early to move directly toward these goals. Both of them, as I see it, are desirable today. Both of them appear inevitable tomorrow, for only by encouraging initiative and competition, in a climate of equal opportunities and obligations, can we assure the maximum contribution of our private financial system to the nation's economic growth and well being.

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