# THE CHALLENGES AND CHANGES CONFRONTING ALABAMA BANKERS

An Address

by

Monroe Kimbrel, President
Federal Reserve Bank of Atlanta

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The Challenges and Changes Confronting
Alabama Bankers

Bankers face challenges today that, in one form or another, will likely confront each of us here and will require that we make major adjustments in our current approach to banking. As a result, it is important that we anticipate and understand the changes that are coming so we can act to minimize disruptions in our businesses. Forethought will allow time to make orderly plans and to smoothly implement them.

Considering the future, a reasonable assessment of changes looming on the banking horizon suggests that the business is going to take on a new look. Even a brief catalog of coming changes which will present strong challenges for banking should include the following:

1. The modifications in bank structure stemming from the holding company movement;

2. The modifications in the full range of banking services to upgrade and expand them, while at the same time making the services more convenient to the public;

3. The increase in competition from nonbank financial institutions and a corresponding shift by the banking industry into new banking and nonbanking activities; and

4. The increase in regulation of financial transactions involving consumers and related financial activities thought to affect the public interest.

As traumatic as these changes might appear at first glance, it seems best to view them in a realistic and proper perspective. First, most of these changes are going to evolve slowly over the coming years; they will

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not all be suddenly confronting us upon our arrival home. Next, you would be helped, I am sure, by measuring their potential impact against some of the challenges you have successfully absorbed in just the past ten or fifteen years. A moment's reflection on these past challenges and your responses to them should be reassuring, for many of the past changes also seemed traumatic at first.

## Bankers Have Responded to Challenges In Recent Years

Let us look briefly together at your response to past requirements, typically with considerable talent and ability.

Certainly, a recent challenge that undoubtedly taxed your potential for response was the strong demand for credit placed on bankers in the Sixties and early Seventies, who meanwhile had to struggle with increasing competition for consumer, business, and governmental deposits and the rising interest rates these conditions brought forth. During those years, bank credit in Alabama, while increasing nearly $4 billion in volume or by 240 percent, changed its type and character dramatically to meet new needs of borrowers. Consumer instalment lending moved to the forefront in bank lending. Loans to commercial and industrial firms also rose strongly, as did various types of real estate mortgage loans. Bankers continued to buy large volumes of securities, but, here too, there was a decided shift in purchases during the Sixties. No longer do Alabama bank portfolios consist mainly of U. S. Treasury obligations. In large degree, bankers now purchase state and local government obligations for their tax-exempt features and U.S.

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agency obligations for their higher yields.

To meet new credit needs and expand the volume of credit granted, bankers made a major shift in the types of deposits they sought. While total deposits increased slightly more than 200 percent since 1960, demand deposits, formerly bankers major source of funds, advanced only about 100 percent. The largest gains came from time and savings deposits which grew by 450 percent! This large gain resulted from bankers' aggressive marketing of consumer CD's, and in turn brought substantial increases in interest costs for banks. However, time deposit growth did serve to lengthen the maturity of deposits and in this connection may have encouraged a re-alignment in the types of credit extended by banks. There is a strong similarity between types of loans that banks are willing to make and types of deposits they hold. With a longer-deposit maturity, many banks have been willing to extend real estate loans for longer maturities and make more term loans to businesses. However, increased interest costs have also spurred bankers to work their assets harder, and this could account for bankers' attempts to increase yields of their investment portfolio by purchasing more municipals and agency issues in the past decade.

Also, since 1960, there has been a significant change in banking offices in Alabama as new banks were chartered and additional branches established. The number of new banks chartered was relatively small, only 35, thus bringing the total number of Alabama banks to 273. However, the number of branches rose dramatically, from 90 in 1960 to 317 by last year, with much of this increase occurring in the recent years. The number of

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Branch offices now exceeds the number of banks, whereas in 1960 there were over two and one-half banks for every branch office.

New banking facilities grew most dramatically in those areas where population was rising most rapidly, thus helping to make banking more convenient to the public. To assess the magnitude of this development, note that the number of banking offices in Alabama rose from 10 per 100,000 persons in 1960 to the current level of about 16 per 100,000 persons. This ratio places the state much closer to the national level.

Perhaps the most far-reaching institutional change in Alabama banking in recent years was the conversion from nonpar to par banking. While the number of nonpar banks was clearly declining prior to legislative action on par clearance in 1971, final figures show that about 60 banks were converted from nonpar to par status. Indirectly, this caused changes in correspondent bank relationships and in the manner that checks were cleared, both in Alabama and outside the state. This change alone was most important for the banking industry in Alabama. It reflects well on Alabama bankers, for it clearly brought state banking practices in line with modern check payment standards followed in most other states.

Finally, in the past ten years you have gained experience in handling problems which arise during periods of credit restriction and loss or dis-intermediation of deposits. In meeting loan requests, you found that it was no longer enough to reduce holdings in your security portfolios. You developed new liability management techniques to meet the new situation. At times, interest rate ceilings resulted in a shift of deposits from your banks to nonbank financial institutions and open market financial instruments. You

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tempered some of these outflows of deposits by paying higher rates and offering the new longer maturity time deposits. You became used to offering large denomination CD's to business firms, and state and local governments. In short, you developed new ways of acquiring funds that enabled you to continue meeting some of the more urgent and necessary requests for loans for consumers, businesses, and local governments at a time when credit was generally restrictive.

All of these major changes I have just recounted dramatically affected the ways bankers conduct their businesses. Bankers responded to those changes quite effectively. Thus I can say that any group of businessmen exhibiting the necessary talent to deal successfully with such major changes while also increasing their over-all profitability surely can respond successfully to the challenges now ahead.

## Significant New Challenges Loom Ahead

From this position of strength, we can view the challenges ahead in a constructive light. We should note that many apparent challenges for the future represent steps that Alabama bankers will contemplate for further adapting to past changes. Present challenges viewed in this positive context provide beacons for better coping with the problems of today.

In Alabama and elsewhere, the banking industry is being pressed by competition. It is increasingly turning to the bank holding company as a flexible type of corporate structure that might enable banks to be more competitive and allow for easier expansion into new markets. Bank holding companies may also provide an increase in the range of banking and nonbanking services available to the public, and possibly an improvement in them.

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Although we might not always agree with the particular vehicle chosen by many banks, there evidently are advantages to the bank holding company structure, or a great many bankers are wrong in their plans.

I should like to examine further how the bank holding company _might_ be the form of corporate organization that could enable Alabama bankers to meet present challenges and better cope with difficulties of the day. Let me clarify what I connote by the term "bank holding company form of corporate organization." We should look at the meaning to avoid bristling at even the mention of the word "holding company," thus closing our minds to consideration of its advantages. The term "bank holding company" need not stand for or mean the domination of small banks by a large lead bank, which is the criticism of bank holding companies that I most often hear. True, the bank holding company form may involve only one bank or it may involve several banks. But the holding company organization, _per se_, can be a useful structure for a bank or several banks, just as the corporate form of organization is better suited for some businesses than proprietorships or partnerships.

It seems to me that an encouraging trend is now developing in Alabama where several holding companies are being formed by medium and small-sized banks. As I view these cases, no one bank will dominate the organization and all participating banks can share its advantages. Neither does it follow that holding company banks must dominate local banking markets. All acquisitions by holding companies receive Federal Reserve approval and are subject to the same antitrust laws as any other business. It is possible, however, that the holding company influence would benefit local banking

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markets by offering customers of banks new and better services. In this respect, bankers would more fully meet the obligation they assumed when they were given a bank charter--to offer new and better services to the public.

There are some specific ways in which a holding company can aid a bank. As I have noted, Alabama banks grew in the past thirteen years both in deposit size and in the number of new banks and banking offices. In the process, the banking industry required considerable new capital funds. Based upon two major determinants of bank growth--personal income and population--the future is likely to require even more capital investment than the $360 million increase in capital of Alabama banks since 1960. Estimates show that personal income should grow nearly 40 percent during this decade and 50 percent in the next decade. In addition, the population of Alabama is projected to expand almost 11 percent in each of the next ten years. This almost guarantees growth in Alabama banks--a growth requiring considerable additional capital funds to enlarge existing banks and to charter new banks.

Because a multibank holding company is apt to have large resources and be financially stronger and better known than many of Alabama's smaller banks, it should be better able to attract capital funds. A holding company may by its scope and size enjoy a high credit rating, enabling it to acquire capital funds more readily from a range of investors than might be the case with a smaller bank. The wider choice of financial instruments available to the holding company could reduce capital costs and allow the parent organization to strengthen the capital position of its affiliate banks.

Upgrading and expanding the traditional range of banking services will require not only additional capital investment but also investment in new

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personnel and training. The difficulty of attracting and holding capable employees for their officer ranks is one area of deficiency in bank management that bankers themselves point out in applications for a holding company acquisition. Presumably, a holding company can offer a competitive salary and up-to-date fringe benefits, thus greatly reducing the staffing problems of its banks. Training costs should also be reduced and the quality of training improved as the holding company is able to centralize training operations and minimize personnel turnover.

Other obvious personnel advantages should also accrue to the affiliated banks--such as developing and sharing highly specialized services and personnel not needed full time by any bank. Some of these specialized services may improve the internal operations of the affiliated banks, especially in the functions of data processing, auditing, accounting, and credit analysis, and in advertising and marketing programs. Other programs which offer opportunities for the affiliated banks to extend new and improved services encompass expanded mortgage lending, data processing services, leasing, agricultural and forestry credit, trust and investment services, international banking services, and certain insurance services. The economies and benefits from having a staff of "in-house" specialists does seem to promise considerable benefits to both the banks and the banking public.

## Hunt Commission Recommendations An Indicator of Change

If the recommendations of the Hunt Commission are any indication of the direction in which legislation involving financial institutions will be moving, we may well expect increased competition between banks and nonbank financial

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institutions as the regulations applying to each group are equalized. The major competitive pressures confronting Alabama bankers in the coming years are not apt to be from other Alabama bankers. The major competition could well come from other bankers outside the state and other financial institutions in the state, some of which may be subsidiaries of out-of-state bank holding companies.

You can see signs of this trend already. Commercial banks in Connecticut and Massachusetts are not nearly as challenged by other commercial banks as they are by the generally conservative savings banks. These savings banks suddenly began offering NOW accounts, which are, in effect, interest-paying demand deposit accounts. In Alabama, the First National Bank of Boston is already represented in the Alabama mortgage loan market through its local affiliate, Cobbs, Allen, and Hall. The possible avenues for entry into the Alabama banking markets are numerous. Who can say, for example, that an out-of-state bank will not seek to enter the market for international banking services by establishing an Edge Act subsidiary in Mobile? And just last month, the Federal Home Loan Bank Board instituted changes that broadened the lending powers of savings and loan associations to make loans outside their local geographic markets.

Perhaps bankers can better meet such competitive thrusts through the holding company structure. By placing some nonbank activities into subsidiaries, a holding company may better meet the competition in its "home" market, and in locales that it would not be free to enter operating solely as a bank. Subsidiaries of bank holding companies may legally establish offices and provide services in areas beyond the state branching limits of banks. Services in the fields of mortgage finance, consumer finance, data processing, and trust investments stand out as examples of types which holding company subsidiaries

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are providing in numerous places in their home state and even in other states.

We should observe too that the multibank holding company can allow individual banks in its organization to better handle large or unexpected requests for credit. When smaller banks in the holding company are limited in their ability to extend credit to local customers, affiliate banks can participate in the loans. Also, if demands for credit are stronger in some locales where the organization is represented, participations within the group of banks can help balance the loan portfolio of all of them.

Holding company affiliation need not result in local customers of banks in the smaller communities being denied access to credit, as is often suggested. Typically, we find that the smaller banks seeking holding company affiliation have the majority of their earning assets not in loans but in U. S. Government and state and local government securities. Also, these same banks may be selling their excess reserves in the Federal Funds market. Thus, even if some local banks affiliated with a holding company become net purchasers of loan participations from other affiliated banks, we cannot automatically conclude that fewer credit requests are being accepted in local places.

## The Challenge of Social Responsibility

I should like now to consider a remaining challenge--really a series of challenges--that will likely become an increasingly important concern to bankers in coming years. Bankers are just now beginning to feel the brunt of a movement which maintains that businesses in general, and the banking industry in particular, must accept greater responsibility in working to resolve the country's social problems, however they be defined. Bankers are apt to

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be held to a greater accountability for their actions or inactions than they have in the past. They may find that what is "legal," or what was done in the past, may not be considered "right," "fair," or "acceptable," by new standards of business behavior. Our industry is particularly vulnerable to these charges because banking is essentially a business of public trust.

The truth-in-lending regulations applied to credit transactions in the late Sixties grew out of a reaction to alleged credit abuses that had come to light. Also, the fair credit reporting requirements reflect a belief that the consumer operates at a considerable disadvantage in some of his credit transactions with financial institutions. Perhaps the most potentially serious proposal being mentioned involves placing of limits on "the holder in-due-course doctrine" in connection with consumer credit. Bankers could then become responsible for goods sold through the dealer paper they buy and through purchases made with their own credit cards. This may seem an extreme action, but it is certainly a distinct possibility in some form or other in the near future.

We have also seen advocates of housing, consumer interests, municipal governments, and small businesses become vocal in trying to prevent their sectors from being shut out of the credit market in favor of larger corporations in periods of credit restraint. Many banks, of course, continue to lend to these local interests during such periods, but this has not diminished the complaints. When there is a credit shortage and credit must be rationed, those local interests that do not get all the credit that they want at the rates they desire feel that perhaps big businesses should not be getting any credit at all. This is certainly a difficult problem for bankers to resolve and one

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that is even now cropping up in a slightly different form. The Committee on Interest and Dividends is exerting particular pressure on banks to limit increases in lending rates on loans to small business and farmers in order to protect them against burdensome increases in borrowing costs.

Bankers, as well as other businessmen, are being questioned about employment practices and personnel policies. Those working directly in the cause of equal employment opportunities for racial minorities and women maintain that the banking industry needs to do more to hire and promote those discriminated against in the past. Bankers are particularly vulnerable to some of these charges, simply because many of their lower-paid employees are women and racial minorities and few have become bank officers with meaningful positions of responsibility.

Nor are bankers' trust departments apt to be exempt from social criticisms. Many critics now claim that investments made by trust departments should only be in "socially responsible" companies, or that shares of stock in companies not "socially responsible" should be voted by the bank to press them into greater social responsibility. Many of these critics fail to consider how all this fits in with the bank's fiduciary responsibility to the trust beneficiaries, but this seems to be only of slight concern to them. Nevertheless, bankers, because they control large amounts of assets and make investments in the nation's major companies, do remain vulnerable to charges that they should really do more to solve social problems.

Regardless of our personal inclinations, many social activists are demanding that bankers do better in public dealings and in the way that they

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handle their affairs. They are charging that bankers have not done enough in the past to help alleviate our social problems. Whether these charges are right or wrong, I think we need to be aware of them and where possible plan reasonable steps to correct any abuses or remove any suspicion that bankers are not concerned with the public interest.

## An Eventful Future Is Likely

In conclusion, I think you will agree that we are going to confront many challenges in coming years. Some of these reflect an attempt by bankers to overcome problems they have faced in the past. Other challenges will involve the way in which bankers serve the public. We must all be aware of charges that bankers are not doing enough to help alleviate social problems and that they cannot continue to simply accept deposits from the public and make sound loans and investments. Bankers will not be charged with doing anything wrong, only with not doing enough. As you work in your individual banks, you are going to have to carefully scrutinize current practices in all phases of your operations to ascertain that any dealings with the public, particularly consumers, are fair, and that your other policies are not just legal, but acceptable and fair. I believe that our attention to these challenges now, gives us the opportunity to think about them, and prepares us to handle them constructively when we meet them in the future.

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