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 MICHIGAN BANKERS ASSOCIATION
 MACKINAC ISLAND, MICHIGAN
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I. INTRODUCTION

A. GIVEN THE EVENTS OF THE PAST FEW MONTHS, INDEED, THE PAST FEW WEEKS, WE SEEM TO BE IN ONE OF THOSE PERIODS WHEN THE BANKING INDUSTRY IS FACED BY PARTICULARLY DIFFICULT CIRCUMSTANCES

1. THE PACE OF CHANGE HAS SIGNIFICANTLY ACCELERATED

A. TRITE -- BUT UNIQUELY TRUE

2. AS A CONSEQUENCE, WE ARE NOW DEALING WITH SOME VERY SIGNIFICANT PRESSURES AND PROBLEMS

3. FEDERAL RESERVE SYSTEM, AS THE NATION'S CENTRAL BANK AND A REGULATOR OF MANY OF OUR FINANCIAL INSTITUTIONS,

Very Significant
~~ALSO FACES SOME IMPORTANT ISSUES AND CHALLENGES AS~~
~~WE TRY AND DEAL WITH THESE ISSUES~~
important issues.

As I frequently suggest, the Federal Reserve is perhaps going through its most challenging & exciting phase in our 70 year history of System

B. JUST TO REFRESH YOUR MEMORY, WOULD LIKE TO ENUMERATE
SOME OF THE MORE IMPORTANT DEVELOPMENTS IN THE FINANCIAL
SERVICES INDUSTRY SINCE LAST YEAR'S MBA MEETING HERE

1. BANKAMERICA ACQUIRED SEAFIRST, A MAJOR INTERSTATE
DEVELOPMENT

2. CITICORP ACQUIRED FIRST FEDERAL IN CHICAGO AND NEW
BISCAYNE FEDERAL IN MIAMI -- ANOTHER IMPORTANT
INTERSTATE DEVELOPMENT

3. THE COMPTROLLER OF THE CURRENCY HAS APPROVED *Several*
Financial Corp
APPLICATIONS FOR BANKS FILED BY DIMENSION. ~~THEN~~
establishing first four
~~THE COMPTROLLER REIMPOSED THE MORATORIUM ON "NONBANK~~
~~"BANKS"~~

4. THE FEDERAL RESERVE BOARD, IN A WATERSHED DECISION,
GAVE APPROVAL TO U.S. TRUST CO. TO CONVERT THEIR
FLORIDA TRUST COMPANY INTO A CONSUMER BANK

A. THIS WAS FOLLOWED BY LITERALLY A FLOOD OF SIMILAR
APPLICATIONS

*B. Some 40 B.H.C - 245
Non-Banks in 40 states*

5. GEORGIA PASSED A BILL TO ALLOW ^{tho, 12} ~~GEORGIA~~ BANKS TO
MERGE WITH BANKS IN NINE OTHER SOUTHERN STATES ON A
RECIPROCAL BASIS, THUS LEADING THE WAY FOR A REGIONAL
COMPACT IN THE SOUTHEAST. ~~FLORIDA THEN PASSED A~~

~~SIMILAR BILL~~

6. MAINE'S GOVERNOR SIGNED A BILL THAT ELIMINATES THE
RECIPROcity REQUIREMENT IN ^{that} ~~THE~~ STATE'S INTERSTATE
BANKING LAW, ^{A bill that} ~~THIS~~ CONTRADICTS THE NEW ENGLAND
REGIONAL COMPACT

7. EARLY THIS YEAR, CITICORP GAINED ACCESS TO THE ATMS
IN ~~CALIFORNIA~~ ^{in California} SAFEWAY SUPERMARKETS FOR ITS MASTERCARD,
VISA AND DINERS CLUB ~~CARDHOLDERS~~

8. K-MART BEGAN OFFERING CDs AND MMDAs ISSUED BY A
MICHIGAN S&L IN THREE OF ITS FLORIDA STORES

9. THE BUSH TASK FORCE FINISHED ITS FINAL REPORT ON
THE REGULATION OF THE FINANCIAL SECTOR. ~~A MOVE~~

~~TOWARD "FUNCTIONAL" REGULATION AND INCREASED STATE~~
~~SUPERVISORY POWERS OVER STATE-CHARTERED INSTITUTIONS~~

~~ARE INCLUDED AMONG ITS RECOMMENDATIONS~~

10. AND, OF COURSE, THE RECURRING PROBLEM OF DEALING WITH THE REFINANCING OF THE EXTERNAL DEBTS IN THE INTERNATIONAL MARKETS HAS ADDED A CONSIDERABLE AIR OF TENSION.
11. THESE ARE JUST A FEW OF THE HIGHLIGHTS BUT, NET, IT HAS BEEN A BUSY AND ACTIVE YEAR
- C. THE PESSIMISTS WOULD SUGGEST THAT THE BUILD-UP OF CONFLICTING PRESSURES IS TOO GREAT
 1. WE ARE HEADING FOR A PERIOD OF DESTABILIZED CONDITIONS
- D. WITHOUT IN ANY WAY MINIMIZING THE MAGNITUDE OF THE ISSUES
 1. THE FINANCIAL SYSTEM HAS DISPLAYED AN AMAZING DEGREE OF RESILIENCY IN DEALING WITH THESE CHALLENGES
 2. THE LEVEL OF COOPERATION AMONG THE MAJOR PARTICIPANTS HAS BEEN EXCEPTIONALLY HIGH
- A. THE PROBLEMS AND CHANGES, INTERNATIONAL, DOMESTIC, ET AL, HAVE BEEN MANAGED AND CONTAINED

3. THE REGULATORY RESPONSE, WHERE NECESSARY, HAS BEEN
APPROPRIATE AND EFFECTIVE

4. THE ECONOMIC RECOVERY, FIRST DOMESTIC AND NOW
WORLDWIDE, WILL INCREASINGLY PROVIDE A FAVORABLE
ENVIRONMENT FOR THE SOLUTION TO THESE PROBLEMS

II. LET ME FIRST COMMENT ON DEREGULATION -- THE EVENTS OF THE
PAST YEAR HAVE BROUGHT US TO AN IMPORTANT CROSSROAD -- LOOKING
FORWARD, THERE SEEM TO BE THREE ALTERNATIVE COURSES OF ACTION

First
A. REREGULATION -- THERE WILL BE GROWING POLITICAL PRESSURE
TO IMPOSE NEW CONTROLS OR REIMPOSE OLD CONTROLS

1. AT THIS POINT, GIVEN THE ENORMOUS CHANGES THAT HAVE
TAKEN PLACE, IT IS DIFFICULT TO IMAGINE HOW WE
COULD POSSIBLY REVERT TO THE STRICTURES WHICH EXISTED
UNTIL A FEW YEARS AGO

A. THIS IS A CASE OF TOOTHPASTE BEING LARGELY OUT
OF THE TUBE

2. WE WOULD BE ATTEMPTING TO UNDO THE VAST CHANGES THAT
HAVE BEEN MADE OVER THE RECENT YEARS, WHICH WOULD BE

A VERY DIFFICULT PROCESS

3. VERY UNEVEN AND UNFAIR

4. WITH SOME SIGNIFICANT EFFECT ON THE OUTLOOK FOR THE
ECONOMY WHICH HAS BECOME ACCUSTOMED TO AND HAS ENJOYED
THE BENEFITS OF A MORE FLEXIBLE FINANCIAL STRUCTURE

Second
B. A PAUSE IN THE DEREGULATION PROCESS -- PROVIDE FOR A
COOLING OFF PERIOD

1. THE MOMENTUM OF THE MARKETS IS DIFFICULT TO HALT

2. MORATORIUMS HAVE NOT WORKED IN THE PAST -- THEY
DON'T HAVE ANY EFFECT OR IMPEDE THOSE THAT ARE NOT
COVERED

A. HERE AGAIN, THE PROCESS WOULD BE VERY UNEVEN
AND UNFAIR

3. THIS IS NOT A PRACTICAL RESPONSE TO THE CURRENT
CIRCUMSTANCES

4. IN FACT, THE TIMES CRY OUT FOR LEGISLATIVE ACTION
SO THAT FURTHER CHANGES CAN BE MANAGED ON AN
ORGANIZED AND ORDERLY BASIS RATHER THAN BY AD HOC
MARKET RESPONSE

Three

C. CONTINUED DEREGULATION ON A MANAGED BASIS IS THE ONLY

PRACTICAL ALTERNATIVE

Important

1. THE PROBLEMS THAT WE HAVE BEEN EXPERIENCING ARE NOT
THE RESULT OF DEREGULATION

A. DEREGULATION MAY HAVE COMPLICATED THE ENVIRONMENT --
BUT HAS NOT, PER SE, CAUSED THE PROBLEMS

2. THE DIFFICULTIES HAVE NOT OCCURRED IN ACTIVITIES
NEWLY UNDERTAKEN BY BANKS

A. THESE ~~ESOTERIC~~ NEW FINANCIAL SERVICES *thought
to be rather esoteric by many.*

3. RATHER, BY AND LARGE, THEY HAVE TAKEN PLACE IN THE
TRADITIONAL AND FUNDAMENTAL AREAS OF BANKING --
DEPOSIT TAKING AND LENDING

4. INDEED, IN MANY INSTANCES THE PROBLEMS HAVE BEEN
EXACERBATED BY THE CURRENT LEVEL OF REGULATION

therefore

5. AN IMPORTANT OPPORTUNITY FOR THE LEGISLATIVE PROCESS
TO MOVE FORWARD ON BOTH THE STATE AND NATIONAL LEVELS

III. MEANWHILE, ALMOST SEPARATE AND APART FROM THE LEGISLATIVE
ARENA, MARKETPLACE CHANGES CONTINUE Apace

A. OUR BANK SPONSORS A CONFERENCE ON BANK STRUCTURE AND
COMPETITION EACH SPRING

1. IN MY OPENING COMMENTS THIS YEAR, I SUGGESTED THAT
MARKETPLACE DEVELOPMENTS, WHICH JUST A FEW YEARS AGO
WOULD HAVE SEEMED ALMOST INCREDIBLE, HAVE NOW BECOME
COMMONPLACE
2. WE HAVE BECOME ACCUSTOMED TO THE INVASION OF NONBANKS
ONTO THE TURF PREVIOUSLY THE EXCLUSIVE DOMAIN OF THE
COMMERCIAL BANKS
3. BANKS HAVE NOW BECOME ACCUSTOMED TO COMPETING WITH
DREYFUS, FIDELITY, SEARS, MERRILL LYNCH, ET AL, FOR
NORMAL BANKING TRANSACTIONS
4. IN HIS APRIL 1984 TESTIMONY BEFORE THE SENATE COMMITTEE
ON BANKING, FINANCE AND URBAN AFFAIRS, CHAIRMAN VOLCKER
LISTED 61 NONBANKS THAT HAVE OPERATIONS IN 22 STATES

B. IN STUDIES THAT WE HAVE DONE AT OUR BANK ON THE EFFECT

OF NONREGULATED COMPETITION IN THE FINANCIAL SERVICES
AREA, THE GAINS ACHIEVED BY NONBANKING BASED COMPANIES
IN FINANCIAL SERVICES ARE IMPRESSIVE -- OR SCARY IF YOU
ARE A REGULATED COMPETITOR

1. IN THE STUDIES THAT WE HAVE CONDUCTED OVER THE PAST
SEVERAL YEARS, WE HAVE UTILIZED A BASE OF 32 COMPANIES
INCLUDING A VARIETY OF INDUSTRIAL, COMMUNICATIONS AND
TRANSPORTATION FIRMS SUCH AS GULF & WESTERN, NATIONAL
STEEL, GENERAL ELECTRIC AND GENERAL MOTORS
2. IN 1972, THE BASE YEAR FOR THE STUDIES, THERE WERE
10 FIRMS WHOSE EARNINGS FROM FINANCIAL SERVICES WERE
MOST IMPRESSIVE -- THE COMBINED EARNINGS OF THESE
FIRMS FROM THEIR FINANCIAL SERVICE ACTIVITIES TOTALLED
OVER \$650 MILLION IN 1972
3. BUT BY 1983, THE FINANCIAL SERVICES EARNINGS OF THESE
FIRMS HAD GROWN BY FOUR TIMES TO ALMOST \$3 BILLION.
ABOUT THE SAME AS THE TOTAL WORLDWIDE EARNINGS OF
THE SIX LARGEST BANK HOLDING COMPANIES, ~~RANKED BY~~
~~EARNINGS~~

4. FURTHER, IN ALMOST ALL CATEGORIES OF LENDING AND DEPOSIT TAKING, NONREGULATED FINANCIAL ENTITIES HAVE ACHIEVED IMPRESSIVE GAINS AND NOW ENJOY SUBSTANTIAL MARKET POSITIONS

A. THESE GAINS HAVE COME AT THE EXPENSE OF THE BANKS

(1) THE MOST PROMINENT EXAMPLE IS IN AUTO LENDING WHERE BANKS' SHARE FELL FROM 60% IN 1978 TO 45% IN 1982. OVER THIS SAME TIME SPAN, GMAC DOUBLED ITS SHARE OF ALL AUTO LOANS OUTSTANDING FROM 13% TO 26 %. GIVEN THE IMPORTANCE OF THE AUTOMOTIVE INDUSTRY TO MICHIGAN, THIS STATISTIC SHOULD BE PARTICULARLY RELEVANT.

5. THERE WERE THOSE THAT SUGGESTED THAT ANY LOGICAL CONTINUATION OF THESE TREND LINES OVER TIME WOULD LEAD TO THE CONCLUSION THAT BANKS WOULD BE RELEGATED TO A MUCH LESS IMPORTANT ROLE AS FINANCIAL INTER-MEDIARIES IN OUR SYSTEM

C. BUT, VERY IMPORTANTLY, AS THESE COMPETITIVE PRESSURES
HAVE BUILT UP, THE BANKS, IN TURN, HAVE RESPONDED BY
EXPANDING THE SCOPE OF OFFERED SERVICES AND GEOGRAPHIC
AREAS COVERED

1. MANY OF THE LARGEST BANK HOLDING COMPANIES ARE
ACTIVELY PROVIDING A VARIETY OF SERVICES SUCH AS
COMMERCIAL AND CONSUMER LENDING, LEASING, FACTORING,
DATA PROCESSING, ETC., THROUGH NONBANK SUBSIDIARIES
2. OFFERED ON AN INTERSTATE BASIS
3. BY CURRENT ESTIMATES SOME 140 BANK HOLDING COMPANIES
CONTROL OVER 300 NONBANK SUBSIDIARIES WITH OVER
5,500 OFFICES IN STATES OTHER THAN THE HOME STATE
4. IN ADDITION, THEY OPERATE SOME 200 LOAN PRODUCTION
OFFICES AND 140 EDGE ACT OFFICES IN THE MAJOR CITIES
THROUGH THE U.S.
5. IMPRESSIVE EXPANSION, ESPECIALLY WHEN YOU CONSIDER
THAT THE MCFADDEN ACT AND DOUGLAS AMENDMENT REMAIN
ON THE BOOKS BUT HARDLY EFFECTIVE

D. AND IN 1983 AND SO FAR IN 1984, THE BANKS, LARGE AND SMALL ALIKE, HAVE CONTINUED TO RESPOND IN A HIGHLY EFFECTIVE MANNER RATHER THAN RELYING ON COUNTERPRODUCTIVE PROTECTIONISM

1. FOR EXAMPLE, BANKS ARE ESTABLISHING BROADER GEOGRAPHIC PRESENCE BY GIVING HOLDERS OF MASTERCARD^S AND VISA CARD^S THE ABILITY TO OBTAIN CASH AT ATMS OR SUPERMARKETS OR OTHER RETAIL OUTLETS. IN 1983, DOZENS OF REGIONAL EFT NETWORKS OWNED BY OR LICENSED TO THOUSANDS OF BANKS GAINED INCREASED MARKET PRESENCE AND A NATIONWIDE LINKAGE OF THESE NETWORKS BECAME A REALITY

2. AS AN EXAMPLE OF A NEW AND POTENTIALLY REWARDING SERVICE, BANKS HAVE ^{increasingly} BEGUN TO OFFER DISCOUNT BROKERAGE SERVICES

3. MORE THAN ONE-FOURTH OF OUR STATES HAVE NOW ENACTED LEGISLATION TO PERMIT INTERSTATE BANKING IN SOME MANNER -- THIS IS LEGISLATION THAT COULD NOT POSSIBLY

COME ABOUT IF BANKS, AND IMPORTANTLY BANKS OF ALL
SIZES, DID NOT AGREE THAT THEIR PROSPECTS WERE
IMPROVED BY GREATER GEOGRAPHIC SCOPE

In this geographic issue

A. I SENSE A TREMENDOUS ATTITUDE CHANGE IN WHAT

HAS BEEN A VERY SENSITIVE AREA

5. Opportunity for small + medium sized relatively greater

IF DEREGULATION IS GOING TO CONTINUE AND IF MARKET COMPETITIVE

FORCES ARE GOING TO INTENSIFY, IT STANDS TO REASON THAT THE
MANAGEMENT FUNCTION WILL BECOME INCREASINGLY DIFFICULT --

I SUGGESTED EARLIER THAT THE PROBLEMS THE BANKING INDUSTRY HAS
EXPERIENCED ARE NOT THE DIRECT RESULT OF DEREGULATION

A. THE VOLATILITY IN INTEREST RATES WHICH WE HAVE EXPERIENCED
OVER THE PAST FEW YEARS HAS CERTAINLY COMPLICATED THE
MANAGEMENT PROCESS; THE SEVERE RECESSION THAT ENDED IN
LATE 1982 HAD A MAJOR IMPACT ON ASSET QUALITY, BUT
IMPORTANTLY, THE COMMON DENOMINATOR, AT LEAST IN MY
VIEW, THE CONSISTENT ELEMENT WHICH RUNS THROUGH ALL OF
THE BANKING PROBLEMS WE HAVE EXPERIENCED, IS A FAILURE
IN THE MANAGEMENT PROCESS

Pause
IV.

1. IN THE HIGHLY REGULATED ENVIRONMENT OF YESTERYEAR
WITH A RELATIVELY RESTRICTED RIGHT OF ENTRY, EVEN A
BADLY MANAGED INSTITUTION COULD DO REASONABLY WELL
 - A. IT JUST WASN'T THAT COMPLICATED
2. BUT MARKET DEVELOPMENTS AND VAST STRUCTURAL
MODIFICATIONS HAVE CHANGED ALL OF THAT
3. IT IS IMPORTANT TO REMEMBER THAT ACTUAL ACTS OF
DEREGULATION FOLLOWED ON A DE FACTO BASIS -- THE
MARKETPLACE LED THESE CHANGES BY A VERY CONSIDERABLE
PACE
4. THUS, MY POINT IS THAT THE MARKETPLACE DEVELOPMENTS
HAVE CAUSED THE PROBLEMS, NOT DEREGULATION PER SE,
WHICH ONLY FOLLOWED ON A LAGGING BASIS
 - A. REGULATION AT BEST ONLY TEMPORIZES DEVELOPMENTS
IN THE FREE MARKET ENVIRONMENT
 - B. EVERY ONCE IN AWHILE IT IS IMPORTANT TO REMIND OURSELVES
JUST WHAT THE BANKING BUSINESS IS ALL ABOUT TO BE SURE
THAT THE APPROPRIATE MANAGEMENT TOOLS ARE IN PLACE TO

EFFECTIVELY DEAL WITH A BUSINESS THAT, BY ALL STANDARDS,
HAS BECOME ~~INCREDIBLY~~ COMPLICATED AND SOPHISTICATED

1. CERTAINLY THE CONCEPTS ARE PRETTY SIMPLE -- NO
SURPRISES TO ANYONE HERE

2. YET WITH EACH PROBLEM THERE SEEMS TO HAVE BEEN SOME
OBVIOUS FAILURE IN THE MANAGEMENT PROCESS

C. SIMPLISTICALLY, AND PLEASE BEAR WITH ME, BANKING BUSINESS
INVOLVES DEPOSIT TAKING ON ONE SIDE OF THE BALANCE SHEET
AND LENDING ON THE OTHER

1. NOTHING REVOLUTIONARY ABOUT THAT STATEMENT, YET,
IMPORTANTLY, IT IS IN THESE TWO VERY BASIC AREAS
THAT MOST OF THE PROBLEMS HAVE ARISEN

D. DEPOSITS -- WITH DEREGULATION THERE HAS BEEN A MOVE
TOWARD THE PAYMENT OF INTEREST ON MOST DEPOSITS

1. BUT THOUGH A SUBSTANTIAL PART OF RETAIL ACCOUNTS
NOW INVOLVE THE PAYMENT OF INTEREST, THEY ARE STILL
CORE DEPOSITS IN A FUNDAMENTAL SENSE

2. THEY ARE NOT PURCHASED FUNDS IN A MARKET SENSE --

AS A CONSEQUENCE, THERE IS A HIGHER LEVEL OF
STABILITY INVOLVED

A. THE RETAIL CUSTOMER WITH AN MMDA HAS A FAR
DIFFERENT ATTITUDE THAN THE DISPASSIONATE
INSTITUTIONAL TRADER DEALING FROM A MONEY DESK
IN SOME DISTANT SPOT OF THE WORLD

3. PURCHASED FUNDS CAN BE MUCH MORE VOLATILE; THE
MARKETS AND TRADERS HAVE VAST ALTERNATIVES AND WILL
MOVE FROM ONE INSTITUTION TO ANOTHER FOR A VARIETY
OF REASONS INCLUDING YIELD, MATURITY AND PERCEIVED
CREDIT QUALITY

~~A. AS WE HAVE LEARNED, THESE CHANGES CAN OCCUR
WITH GREAT SPEED~~

4. ASSET GROWTH THAT IS NOT CONTROLLED AND CAREFULLY
MANAGED AND THAT IS SUPPORTED BY AN OVERDEPENDENCE
ON PURCHASED FUNDS AS OPPOSED TO CORE DEPOSITS
CAN AND DOES INTRODUCE A LEVEL OF INSTABILITY

5. THE PURCHASED FUNDS TO EARNING ASSET RATIO IS A

VERY IMPORTANT ITEM OF MANAGEMENT INFORMATION AND
IS ONE THAT SHOULD BE CAREFULLY CONTROLLED

A. DIFFERENT TYPES OF INSTITUTIONS CAN FEEL

COMFORTABLE WITH AND CAN MANAGE TO DIFFERENT
LEVELS OF PURCHASED FUNDS -- BUT ~~UNDETERMINED~~ *excessive*

ASSET GROWTH WITHOUT CAREFULLY THOUGHT THROUGH
MANAGEMENT RESTRAINTS ON PURCHASED FUND LEVELS

SEEMS HIGHLY INAPPROPRIATE

Through Brokerage Process -

E. LENDING -- CLEARLY, COMMERCIAL BANKING IS NOT AND

*Purchased Funds
Not just a character, some
of large Banks*

CANNOT BE A HIGH RISK ACTIVITY IN THE APPROACH TO

LENDING

1. NET INTEREST MARGINS AND RETURNS ON ASSETS SIMPLY

DO NOT PROVIDE ROOM FOR EXCESSIVE RISK TAKING

2. THE RISK-REWARD RELATIONSHIP WILL SIMPLY NOT PERMIT

THE INTRODUCTION OF HIGH RISK INTO THE LENDING

PORTFOLIO

3. THE TOTAL LENDING MARKET, THE TOTAL CREDIT PIE, IF

YOU WILL, MAY NOT HAVE AN ABSOLUTELY FINITE LIMIT

*Shifting
to asset
side*

BUT THERE MUST BE SOME PRACTICAL LIMITS AS TO THE
VOLUME OF LOANS WITH REASONABLE RISKS THAT ARE
AVAILABLE TO THE BANKING MARKET FROM TIME TO TIME.

WITH INCREASINGLY RAPID COMMUNICATIONS, INCREASED
MOBILITY AND REDUCED GEOGRAPHIC RESTRAINTS, I THINK

IT IS POSSIBLE THAT THE FINANCIAL SERVICES INDUSTRY

MAY BE FACING SOME OVERCAPACITY CONSIDERATIONS IN *ITS*

LENDING OPERATIONS. IN ORDER TO DEAL WITH RISING

EXPENSE LEVELS AND TO KEEP EARNING ASSETS INCREASING

AT REASONABLE RATES, SOME BANKERS SEEM TO BE WILLING

TO ASSUME HIGHER THAN ORDINARY RISKS

A. PERHAPS A EUPHEMISTIC WAY OF SUGGESTING THAT

COMPETITIVE FACTORS MAY BE CAUSING A DETERIORATION

IN LOAN QUALITY

 4. HAVING NOTED BANKING'S FUNDAMENTAL ACTIVITIES, LET

ME ENUMERATE JUST A FEW MANAGEMENT GUIDELINES THAT

RECENT HISTORY WOULD SUGGEST BEAR REPEATING

*not an all encompassing list
no order of priority*

Guideline

1

F. CHECKS AND BALANCES -- ANY ORGANIZATION THAT DOES NOT PROVIDE FOR REASONABLE CHECKS AND BALANCES AS A PART OF THE LENDING STRUCTURE MAY WELL BE EXPOSING ITSELF TO PROBLEMS

1. PEOPLE ARE HUMAN AND HUMANS MAKE MISTAKES
2. TO ALLOW LENDING OFFICERS TO HAVE LARGE APPROVAL LIMITS WITHOUT THE CONCURRENT REVIEW AND APPROVAL BY A SEPARATE AUTHORITY CAN PLACE TOO MUCH RESPONSIBILITY ON THE SALES AND MARKETING SIDES OF THE LENDING PROCESS

A. CHECKS AND BALANCES ARE VERY IMPORTANT

Guideline

2

G. PROCEDURES AND CONTROLS -- GIVEN THE CHANGING NATURE OF THE ENVIRONMENT, INSTALLING APPROPRIATE PROCEDURES AND CONTROLS IS CRITICALLY IMPORTANT

1. THESE CONTROLS AND PROCEDURES MUST BE KNOWN, MUST BE UNDERSTOOD AND AGREED TO BY ALL INVOLVED
2. VAGUE UNDERSTANDINGS AS TO JUST HOW THINGS SHOULD WORK, DON'T WORK

3. EVERYONE MUST KNOW JUST WHAT THEY CAN DO, WHAT
THEIR AUTHORITIES ARE, AND JUST HOW THE PROCESS
WORKS

*Guideline
3*

H. MANAGEMENT INFORMATION SYSTEMS -- AGAIN, OUR CHANGING
ENVIRONMENT CRIES OUT FOR CURRENT DATA ON A RAPID BASIS
SO THAT SENIOR MANAGERMENTS WILL KNOW JUST WHAT IS TAKING
PLACE AND CAN FOLLOW EXPOSURES AND RISKS AS THEY DEVELOP
NOT TOO LATE AND AFTER THE FACT

1. IF YOU DON'T HAVE THE INFORMATION, YOU CAN HARDLY
MINIMIZE POTENTIAL OR DEVELOPING PROBLEMS, NOR CAN
YOU TAKE THE RIGHT CORRECTIVE ACTION ON A TIMELY
BASIS -- IT MAY BE TOO LATE

2. IT USED TO BE THAT ONLY LARGE INSTITUTIONS COULD
DEVELOP AND AFFORD TO MAINTAIN SOPHISTICATED
MANAGEMENT INFORMATION SYSTEMS

+
3. BUT REDUCED COMPUTER/SYSTEM COSTS AND VERY MODERN
programs available
MIS ~~SYSTEMS~~ MAKE THIS IMPORTANT MANAGEMENT TOOL
AVAILABLE TO EVEN THE VERY SMALLEST BANKS

Guidelines

#4

I. PROFIT CENTER ACCOUNTING -- THOUGH IT IS CERTAINLY
IMPORTANT TO ESTABLISH ACCOUNTABILITY AND RESPONSIBILITY
THROUGHOUT THE ORGANIZATION, Excessive emphasis on PROFIT CENTER ACCOUNTING
HAS LED TO SOME QUESTIONABLE PRACTICES

1. WHEN THIS LEADS TO A HIGHLY, PERHAPS OVERLY,
COMPETITIVE ENVIRONMENT, AND WHEN COMPENSATION
REWARDS ARE DIRECTLY DERIVED FROM SHORT TERM RESULTS,
A DANGEROUS ELEMENT IS INTRODUCED. THIS SEEMS
HIGHLY INAPPROPRIATE FOR INSTITUTIONS THAT HAVE A
FUNDAMENTAL FIDUCIARY RESPONSIBILITY

#5

J. BOARDS OF DIRECTORS HAVE A BROAD GOVERNANCE RESPONSIBILITY
NOT A DAY-TO-DAY MANAGEMENT RESPONSIBILITY

1. BOARDS CANNOT AND SHOULD NOT MANAGE A BANK
2. BUT THEY HAD BETTER UNDERSTAND THE GOVERNANCE PROCESS
3. I GET A LITTLE enraged at ~~FLEED OF~~ DIRECTORS WHO SAY THAT

BANKING IS A VERY ESOTERIC ACTIVITY AND ONE THAT
THEY REALLY DON'T UNDERSTAND

A. THEY RUN COMPLICATED MANUFACTURING OPERATIONS
WITH GREAT SKILL

4. MANagements have the responsibility to bring the level of awareness of their directors up to the point that the board can properly exercise its governance responsibility
5. If the management is unable to do this, or the directors are unwilling to spend the time, the directors should get off the board
6. Boards of directors should have the appropriate committees which provide an opportunity to review and discuss specific areas of responsibility frequently and in depth
7. Though I am in no way gainsaying the responsibility of the regulators in all this, boards of directors should not defer to the regulators for action
 - A. Through the examination process, and in some cases as a result of discussions with bank managements and directors, regulators do follow the progress of the institutions for which they

HAVE RESPONSIBILITY, BUT IN MY VIEW, REGULATORS
SHOULD NOT INTERCEDE AND ASSUME CONTROL UNTIL
THE MANAGEMENT-GOVERNANCE PROCESS HAS FAILED TO
FUNCTION PROPERLY

8. THE PRIMARY RESPONSIBILITY FOR THE SATISFACTORY
OPERATION OF THE INSTITUTION MUST REMAIN WITH THE
BOARD OF DIRECTORS WHO, IN TURN, CHOOSE THE CHIEF
EXECUTIVE OFFICER -- CERTAINLY THE SINGLE MOST
IMPORTANT DECISION THAT THE BOARD MAKES

well
K. REVIEWING THESE FUNDAMENTAL MANAGEMENT ~~PRECEPTS~~ ^{CONCEPTS} SOUNDS

MORE LIKE THE FIRST CLASS SESSION IN BANKING 101 RATHER
THAN A MESSAGE THAT WOULD BE APPROPRIATE FOR THIS GROUP
^{Senior managers}

1. NO DOUBT YOUR BANK DEALS WITH ALL OF THESE MANAGEMENT
TOOLS IN AN EXEMPLARY WAY

2. BUT SOMEBODY OUT THERE IN THAT BROAD BANKING ARENA
IS NOT ^{not authorized}

3. VIRTUALLY ALL OF THE BANK PROBLEMS OR FAILURES THAT
I HAVE REVIEWED SINCE BEING AT THE FEDERAL RESERVE

BANK OF CHICAGO HAVE INVOLVED ONE OR PERHAPS SEVERAL OF
THESE VERY FUNDAMENTAL MANAGEMENT POLICIES

4. DEREGULATION HAS NOT MADE THE MANAGEMENT ^{Function} ~~RESPONSIBILITY~~
ANY SIMPLER

5. QUITE THE OPPOSITE, IT HAS ELEVATED VERY SIGNIFICANTLY
THE COMPLEXITY OF THE MANAGEMENT RESPONSIBILITY

V. TO CONCLUDE, I HAVE SUGGESTED

A. GIVEN CIRCUMSTANCES, DEVELOPMENTS ON REGULATORY FRONT
MAY TAKE THREE ALTERNATIVE COURSES OF ACTION

1. DIFFICULT TO PREDICT
2. THE POLITICAL WINDS WILL BLOW PRETTY HARD
3. CONTINUED DEREGULATION IS MOST APPROPRIATE

B. COMPETITIVE ASPECTS OF MARKETPLACE ARE CONTINUING TO
CHANGE + *intensify.*

1. NONREGULATED PROVIDERS OF FINANCIAL SERVICES *will*
continue to make inroads.
2. BANKS HAVE RESPONDED WELL PARTICULARLY IN PAST YEAR

OR SO

C. BUT MY EMPHASIS HAS BEEN ON THE MANAGEMENT ASPECTS OF
BANKING

1. I HAVE COVERED THESE ITEMS WITH SOME RELUCTANCE
2. SKILLED MANAGERS SUCH AS YOU HARDLY NEED TO BE
REMINDED HOW TO DO YOUR JOBS -- PARTICULARLY ~~FROM~~ ^{by} A
REGULATOR -- BUT AS A FORMER MANAGER IN COMMERCIAL
BANKING, I HAVE SEEN IT FROM BOTH SIDES
3. SOMEWHERE OUT THERE, NO DOUBT BEYOND THE BORDERS OF
MICHIGAN, MANAGEMENT FAILURES HAVE RESULTED IN
PROBLEMS
4. AS ALWAYS, THERE IS THE RISK THAT ONE INCIDENT WILL
BE GENERALIZED INTO A PREVALENT TREND WHICH, OF COURSE,
IS JUST NOT ACCURATE
 - A. BANKING'S OPPONENTS WILL USE THE OPPORTUNITY ~~TO~~ ^{to further their own objectives}
5. THE POLITICAL RISK
 - A. THE FOES OF DEREGULATION WILL CHARGE THAT MANAGERS
WHO CAN'T HANDLE THE BASICS CAN HARDLY MANAGE NEW
AND ESOTERIC SERVICES -- TRY AND DECLARE HALT
6. MOST UNFAIR -- VAST MAJORITY EXTREMELY WELL MANAGED
 - A. BY AND LARGE, R.O.A.'S AND R.O.E.'S EXCELLENT

D. DID WANT TO USE THE OPPORTUNITY TO REVIEW THESE MATTERS
WITH YOU

1. FROM A REGULATOR'S POINT OF VIEW, THEY STRIKE AT
THE HEART OF ONE OF OUR MAJOR RESPONSIBILITIES

A. THE SAFETY AND SOUNDNESS OF THE FINANCIAL
SYSTEM

2. BUT SAFETY AND SOUNDNESS ARE NOT THE SOLE
RESPONSIBILITY OF THE BANK SUPERVISORY AGENCIES.

AS I HAVE STRESSED THROUGHOUT THIS TALK, BANK
SAFETY IS AS MUCH A MANAGEMENT AND DIRECTORS
RESPONSIBILITY AS IT IS A REGULATORY PROBLEM

3. OFTEN, BY THE TIME REGULATORS FIND A PROBLEM,
THE DAMAGE HAS BEEN DONE AND IT IS TOO LATE TO
TAKE CORRECTIVE ACTION

4. FURTHER, AND THIS IS A CRITICAL POINT, REGULATION
OF THE BANKING SYSTEM WILL NOT ALTER THIS

FUNDAMENTAL FACT OF LIFE • ~~NOR SHOULD IT~~ -- IT
IS NOT AN APPROPRIATE ~~RESULT~~ *Remedy*

5. THE FREE ENTERPRISE SYSTEM, AND CERTAINLY BANKS
ARE AN INTEGRAL PART OF THIS SYSTEM, MUST, BY

DEFINITION, PROVIDE THE OPPORTUNITY FOR RISKS AND

uncertainties that may not always,
~~FOR FAILURE~~ *be successful.*

6. REGULATIONS WILL NEVER BE ABLE TO PROVIDE AN
Financial
ABSOLUTELY FAIL-SAFE ~~REGULATORY~~ SYSTEM

A. WE CAN AND DO DEVELOP APPROPRIATE STANDARDS
AND SAFEGUARDS TO DEAL WITH THE RISK ELEMENT

B. BUT INNOVATION WILL FREQUENTLY FIND A WAY
AROUND THESE SAFEGUARDS

C. REGULATIONS THAT MIGHT BE SO BROAD AS TO
PRECLUDE ANY RISK ELEMENT WOULD BE VERY
BURDENSOME AND WOULD INHIBIT THE PERFORMANCE
OF OUR ECONOMY

D. WHICH IS TO SAY THAT THERE MUST BE TRADE-OFFS
BETWEEN INDIVIDUAL BANK PERFORMANCE AND
MACRO-ECONOMIC ACTIVITY

E. THIS INVOLVES A DIFFICULT BALANCE BUT ONE
THAT IS EXCEPTIONALLY IMPORTANT

F. WHICH IS ANOTHER WAY OF SAYING THAT MORE
REGULATION IS NOT THE ANSWER

Optimistic
Fantastic

E. BUT LET ME END ON A POSITIVE NOTE *Borrow a phrase*
Best of times / worst of times / *management*
issues

1. PARTICULARLY EXCITING AND CHALLENGING TIME, *critically*
important
with
emerg
make
the
diffi
PERHAPS THE MOST IN RECENT HISTORY
2. MOST OF YOU, I AM SURE, HAVE LOOKED FORWARD TO
THE TIME WHEN THE OPERATING ENVIRONMENT WOULD BE
LESS RESTRICTIVE THAN IT WAS FOR SO VERY MANY
YEARS

A. CLEARLY, IT IS WITH US NOW

3. IT IS ALWAYS FUN TO BE INVOLVED WHEN CIRCUMSTANCES
ARE CHANGING, WHEN THINGS ARE MOVING

A. IT PROVIDES AN OPPORTUNITY FOR INNOVATION

4. WHEN HARD WORK AND GOOD, CAREFUL MANAGEMENT
SKILLS WILL BE REWARDED WITH RESULTS

5. AND, WHEN CAPABLE MANAGERS, AND CERTAINLY THAT

INCLUDES THIS GROUP, HAVE THE OPPORTUNITY TO

DEMONSTRATE JUST HOW VERY GOOD ALL OF YOU CAN BE

F. WITH THAT, LET ME CONCLUDE

* * *