

REMARKS OF
MR. ROBERT P. MAYO
PRESIDENT OF THE FEDERAL RESERVE BANK OF CHICAGO
BEFORE THE
NORTHSIDE BANKER'S ASSOCIATION
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I WOULD LIKE TO TALK WITH YOU FOR A FEW MINUTES THIS EVENING ABOUT THE FEDERAL RESERVE SYSTEM. A NUMBER OF COMMENTS HAVE BEEN MADE ABOUT IT IN RECENT MONTHS -- SOME CRITICAL, SOME FAVORABLE -- AND I THOUGHT THAT YOU MIGHT BE INTERESTED IN SOME OF MY PERCEPTIONS OF THE SYSTEM AND ITS MANY ROLES. I OBVIOUSLY WON'T TRY TO COVER EVERY ASPECT OF THE SYSTEM IN DETAIL BUT PERHAPS BY GIVING YOU A ROUGH OUTLINE I'LL REMIND YOU OF SOME QUESTIONS YOU WANTED TO RAISE. I WILL TRY TO LEAVE AS MUCH TIME AS POSSIBLE SO THAT YOU CAN LEAD MY COMMENTS INTO AREAS THAT ARE OF MOST INTEREST TO YOU.

I SUPPOSE THAT ALL OF YOU HAVE, AT ONE TIME OR ANOTHER, BEEN ASKED TO DESCRIBE WHAT THE FEDERAL RESERVE SYSTEM IS AND DOES. OBVIOUSLY, I'VE BEEN ASKED THAT MANY TIMES. IT IS ALWAYS INTERESTING THAT THE VIEW OF THE SYSTEM HELD BY THE AUDIENCE IS STRONGLY INFLUENCED BY THE ASPECTS OF THE SYSTEM WITH WHICH THE AUDIENCE IS MOST FAMILIAR. CONSUMER GROUPS WANT TO TALK ABOUT "TRUTH IN LENDING" OR HOW WE HANDLE THE SALES OF TREASURY SECURITIES TO INDIVIDUALS. ECONOMISTS AND ACADEMICS WANT TO TALK ONLY ABOUT MONETARY POLICY AND RECENTLY THE "GREAT DEBATE" ON M_1 VERSUS INTEREST RATES AS POLICY GUIDES. GROUPS REPRESENTING NON-BANK FINANCIAL INSTITUTIONS WANT TO TALK ABOUT "NOW" ACCOUNTS AND ACCESS TO FEDERAL RESERVE SERVICES.

COMMERCIAL BANKERS TEND TO HAVE THE BROADEST CONCEPTION OF THE FEDERAL RESERVE SYSTEM BUT STILL ARE MOST INTERESTED IN THE REGULATION AND SUPERVISION OF BANKS AND THE PAYMENTS MECHANISM.

THE SHARPLY DIFFERENT PERCEPTIONS OF THE FED'S ROLES STILL REMAIN BUT ARE GRADUALLY MERGING. THERE IS MORE FREQUENT RECOGNITION OF THE FACT THAT THE FED IS NOT SIMPLY A COLLECTION OF DIVERSE ACTIVITIES. THERE IS A COMMON THREAD. WHILE WE DEAL WITH BANKS, WITH GOVERNMENT AND THE PUBLIC, THE COMMON ELEMENT, THE BASIC EFFORT OF THE FEDERAL RESERVE SYSTEM, IS TO MEET ITS BROAD RESPONSIBILITIES TO THE PUBLIC AT LARGE. THE FED HAS A PUBLIC PURPOSE. ITS OBJECTIVE IS ESSENTIALLY TO SERVE THE PUBLIC INTEREST.

IT MAY SEEM STRANGE TO YOU THAT I STRESS THIS. YOU KNOW THAT THE SYSTEM WAS CREATED BY CONGRESS AND CAN BE CHANGED OR MODIFIED AT ANY TIME THAT CONGRESS WISHES. IT SEEMS OBVIOUS THAT THE FED HAS A PUBLIC PURPOSE OR OBJECTIVE.

BUT, INTERESTINGLY, THAT HAS NOT BEEN THE WAY IN WHICH THE FED HAS BEEN VIEWED BY MANY IN OUR SOCIETY. BECAUSE OF ITS EXTENSIVE INTERACTION WITH ONE INDUSTRY -- COMMERCIAL BANKING -- THERE HAS BEEN A WIDESPREAD MISCONCEPTION BY THE PUBLIC, BUSINESS MEN, SOME MEMBERS OF CONGRESS, AND EVEN SOME BANKERS, THAT THE FED SERVES A PARTICULAR PRIVATE INTEREST RATHER THAN THE PUBLIC INTEREST. IT HAS BEEN VIEWED AS A SPECIAL KIND OF CORRESPONDENT BANK OR EVEN ON OCCASION AS A TRADE ASSOCIATION.

I STRESS THE MISCONCEPTIONS OF THE FED'S PURPOSE AND THE FACT

THE FED HAS A PUBLIC ROLE BECAUSE AS OUR SOCIETY HAS BECOME MORE CONCERNED WITH THE RESPONSIVENESS OF INSTITUTIONS TO PUBLIC NEEDS AND VALUES, THERE HAS BEEN A GREAT DEAL OF CONFUSION ABOUT WHAT THE FED IS AND HOW IT SHOULD BE EVALUATED. ON ONE SIDE, EFFORTS ARE SOMETIMES MADE TO EVALUATE PERFORMANCE IN SUCH AREAS AS THE PAYMENTS MECHANISM AS THOUGH WE WERE SERVING A PRIVATE INTEREST. ON THE OTHER, PERFORMANCE IN AREAS SUCH AS BANK SUPERVISION ARE SUPPOSEDLY BEING VIEWED FROM A PUBLIC INTEREST STANDPOINT, BUT YET THE PROCEDURES PROPOSED SEEM TO MEET PRIVATE INTEREST OBJECTIVES TO THE DETRIMENT OF THE PUBLIC INTEREST.

USING THE PUBLIC INTEREST PURPOSE AS THE BACKGROUND, LET'S LOOK AT A FEW OF THE FED'S FUNCTIONS. THREE OR FOUR CATEGORIES ACCOUNT FOR THE MAJOR PART OF OUR ACTIVITIES IN THE FED -- THE PAYMENTS MECHANISM, FISCAL AGENCY RESPONSIBILITIES, THE SUPERVISION OF BANKS, AND, OF COURSE, MONETARY POLICY.

AS BANKERS, YOU ARE ALL VERY FAMILIAR WITH OUR PAYMENTS MECHANISM ROLE BUT LET ME TAKE A FEW MINUTES TO SKETCH OUT WHAT SEEMS TO BE THE MAJOR PUBLIC INTEREST CONCERNS AT THE MOMENT.

NOW, OF COURSE, IF WE ARE TALKING ABOUT THE PAYMENTS MECHANISM, WE SHOULD PROBABLY AT LEAST MENTION OUR ROLE IN PROVIDING CURRENCY AND COIN. BUT THERE ISN'T ANYTHING PARTICULARLY EXCITING ABOUT QUESTIONS SUCH AS: WHAT HAS HAPPENED TO THE 62 MILLION HALF DOLLARS WE'VE DISTRIBUTED IN THE MIDWEST ALONE SINCE 1973? WHERE HAVE THE BICENTENNIAL COINS GONE -- \$27 MILLION IN HALVES, QUARTERS AND DIMES? WHAT WILL HAPPEN TO THE \$2.00 BILL WHEN IT IS ISSUED IN APRIL? IS ANOTHER PENNY SHORTAGE LIKELY?

I SUSPECT YOUR INTEREST IS PRIMARILY CENTERED ON THE FEDERAL RESERVE'S TRADITIONAL ROLE AS THE LINK BETWEEN 14,000 COMMERCIAL BANKS IN THE COUNTRY FOR CLEARING AND SETTLING MONEY PAYMENTS. THE COMMUNICATION, ACCOUNTING AND SORTING ARRANGEMENTS FOR MOVING MONEY AND MONEY AUTHORIZATIONS BETWEEN EACH PAIR OF 14,000 BANKING INSTITUTIONS IS A FORMIDABLE COMPLEX OF MACHINERY TO SAY THE LEAST. IF IT WERE TO BREAK DOWN OR SHUT DOWN, CHECK BACKLOGS WOULD PILE UP AT THE RATE OF 30-40 MILLION ITEMS PER DAY. AND, AS YOU KNOW, THE DOLLAR VOLUME OF TRANSFERS GOING THROUGH THE RESERVE ACCOUNTS AT THE FED ARE HUGE -- MORE THAN \$25 TRILLION A YEAR IN WIRE TRANSFERS ALONE AND ANOTHER \$4 TRILLION IN CHECKS.

I HARDLY NEED TO TELL YOU AS BANKERS, HOW RAPIDLY THE PAYMENTS MECHANISM HAS BEEN CHANGING IN TERMS BOTH OF FORM ON PAYMENT AND INSTITUTIONAL PARTICIPATION. NOR DO I NEED TO DWELL ON THE CHANGING PUBLIC PERCEPTIONS AND CONCERNS WITH THE PAYMENTS MECHANISM. WHAT HAD BEEN A LITTLE KNOWN AREA -- SOMETHING THE PUBLIC NEVER THOUGHT ABOUT -- HAS BECOME PART OF THE PUBLIC DEBATE. THE PUBLIC HAS BECOME INTERESTED, EVEN CONCERNED, ABOUT THE FORM OF PAYMENT, CONFIDENTIALITY IN ELECTRONIC TRANSFERS, THE LOSS OF FLOAT THROUGH SPEEDER OR INSTANTANEOUS CLEARING AND THE GROWING IMPERSONALITY OF CUSTOMER-BANK RELATIONSHIPS.

THAT CHANGE IN PUBLIC PERCEPTIONS HAS BEEN PART OF THE REASON FOR CONGRESSIONAL CONCERN. THE OTHER REASON FOR CONGRESSIONAL INVOLVEMENT IS THE NECESSITY OF BALANCING MANY EQUITIES IN MONEY TRANSFERS FOR THE PUBLIC'S BENEFIT.

THE COMMISSION ON ELECTRONIC FUNDS TRANSFER HAS HAD A VERY SLOW START -- EVEN THE PROCESS OF SELECTING MEMBERS HAS TAKEN FAR LONGER THAN EXPECTED. NEVERTHELESS THE LEGISLATION SHOULD BE HELPFUL IN ESTABLISHING PUBLIC INTEREST PRIORITIES AND IN CLARIFYING THE RESPONSIBILITIES OF VARIOUS PARTICIPANTS IN FUNDS TRANSFER. OF COURSE, IT WILL BE A FORMIDABLE AND COMPLEX TASK. IT WILL OBVIOUSLY BE A WHILE BEFORE IT CAN BE ACCOMPLISHED.

YOUR EQUITY AS BANKERS IN THE PAYMENTS MECHANISM IS SIGNIFICANT. YOU'VE DEMONSTRATED YOUR INTEREST AND YOUR ABILITY THROUGH DEVELOPMENT AND EXPERIMENTATION WITH MANY TECHNIQUES AND PROCEDURES. THERE IS, HOWEVER, A STRIKING DIFFERENCE BETWEEN THE BACKGROUND FOR YOUR DECISIONS IN THIS AREA NOW AND EARLIER AND BETWEEN DECISIONS IN THIS AREA AND YOUR OTHER ATTEMPTS TO IMPROVE YOUR EFFICIENCY OF OPERATIONS. THAT IS THE CLEARER IDENTIFICATION OF THE PUBLIC INTEREST IN THE PAYMENTS MECHANISM. NOT THAT PUBLIC INTEREST HAS NOT ALWAYS BEEN A BANKER CONSIDERATION. NOW, HOWEVER, THE SPELLING OUT OF THAT INTEREST BY OTHERS WILL ACT BOTH AS A CONSTRAINT AND A PROD IN A MUCH MORE SIGNIFICANT MANNER.

IN THAT ENLARGED PUBLIC ARENA, THE MAJOR ISSUES ARE STILL NOT RESOLVED. WHO SHOULD HAVE THE MAJOR RESPONSIBILITY FOR DEVELOPING AND OPERATING THE SYSTEM FOR HANDLING OF MONEY PAYMENTS? IS IT A PRIVATE OR A PUBLIC FUNCTION? IS THE CONTINUATION OF A MIXED PRIVATE AND PUBLIC RESPONSIBILITY IN THE BEST PUBLIC INTEREST? IF THERE IS A CLEAR PUBLIC INTEREST, WHO SHOULD HAVE ACCESS?

I KNOW THAT THESE ARE QUESTIONS THAT BOTHER YOU. THEY BOTHER US AS WELL. IT WOULD BE PRESUMPTUOUS OF ME, TO SAY THAT I HAVE THE ANSWERS.

MY CRYSTAL BALL IS CLOUDY TOO, BUT IT SEEMS TO ME THAT THERE ARE SOME ELEMENTS IN THE PROPOSALS OF THE FINANCIAL INSTITUTIONS ACT OF 1976 THAT MAY SUGGEST A DIRECTION. THE HOUSE COMMITTEE ON BANKING, CURRENCY AND HOUSING HAS PROPOSED THAT ALL FINANCIAL INSTITUTIONS USING THIRD PARTY PAYMENTS ACCOUNTS HAVE SIMILAR RESERVE REQUIREMENTS, THAT INSTITUTIONS BE CHARGED FOR THE USE OF THE ACCOUNTS AND THAT INTEREST BE PAID ON THE RESERVE ACCOUNTS.

I RECOGNIZE FULLY THE SERIOUS ISSUES OF POTENTIAL DAMAGE TO DUAL-BANKING THAT ARE INVOLVED. BUT I ALSO AM KEENLY AWARE OF THE EQUITY ISSUES INVOLVED. IF THE PAYMENTS MECHANISM IS OPERATED IN THE PUBLIC INTEREST AND ALL INSTITUTIONS ARE TO BE GRANTED EQUAL ACCESS, THEN ALL SHOULD CARRY THE BURDEN EQUALLY.

EMOTIONS ON THESE ISSUES RUN HIGH. AS MUCH AS WE MIGHT ALL LIKE TO GO BACK TO AN EASIER LESS CONFLICTING TIME, THE ISSUES ARE NOT GOING TO GO AWAY. IT IS ONLY A MATTER OF HOW AND WHEN.

THE GROWTH OF PUBLIC INTEREST CONCERNS IN SUCH FED ROLES AS FISCAL AGENCY RESPONSIBILITIES HAS BEEN FAR LESS. THE GENERAL PUBLIC INTEREST HAS BEEN LARGELY CENTERED ON OUR AGENCY ROLE IN SELLING TREASURY ISSUES. OVER THE LAST FEW YEARS, WE'VE BEEN PLACED IN THE POSITION OF DOING SOMETHING ABOUT OUR "MERCHANDISING" ACTIVITIES. THE PUBLIC DOESN'T DISTINGUISH BETWEEN THE TREASURY AND THE FED. AND SO WE GET CRITICISM OF THE INTEREST RATES "WE" OFFER AND HARSH WORDS WHEN THE INDIVIDUAL HAS TO "COUGH UP" SOMETHING MORE THAN EXPECTED ON AN AUCTION. AND WE HAVEN'T BEEN PARTICULARLY EQUIPPED FOR "WALK-IN" TRAFFIC. IT'S A NEW

EXPERIENCE TO HAVE TO WORRY ABOUT WASH ROOMS FOR "OUR CUSTOMERS" AND CHAIRS SO THEY CAN SIT DOWN WHILE WAITING.

BUT AS I SAY, THE PUBLIC INTEREST CONCERN IS NOT SIGNIFICANT HERE. IF THE TREASURY WERE TO MOVE TO FULL BOOK-ENTRY AND THE ELIMINATION OF DEFINITIVE SECURITIES IT MIGHT BE ANOTHER STORY.

THE "HOTTEST" PUBLIC INTEREST ISSUE AROUND NOW, OF COURSE, IS THE SAFETY AND SOUNDNESS OF BANKS. THE ORIGINS OF THE DEBATE ARE WELL KNOWN -- FRANKLIN NATIONAL, SAN DIEGO AND THE REIT'S. THE PRESSURE FOR DISCLOSURE IS A RATHER DISTURBING ELEMENT TO ME. I AM NOT OPPOSED TO REASONABLE AND MEANINGFUL DISCLOSURE. PARTICIPANTS IN THE MARKET FOR BANK DEBT AND EQUITIES SHOULD BE ABLE TO DIFFERENTIATE ACCURATELY AMONG INSTITUTIONS AS TO SOUNDNESS, EARNING PROSPECTS AND MANAGEMENT CAPABILITY. BUT IMPROPER DISCLOSURE AROUSES NAIVE CONCERN THAT CAN ADVERSELY AFFECT THE BANK AND ULTIMATELY THE METHODS OF FINANCING IN OUR ECONOMY.

TO ME, THERE IS A SIGNIFICANT CONFUSION IN THE RISING PUBLIC PRESSURE FOR DISCLOSURE. ON ONE HAND, INCREASED INFORMATION TO THE INVESTOR MAY SERVE TO PROTECT HIS INVESTMENT, BUT ON THE OTHER, IT MAY ALSO SET IN TRAIN USELESS AND INAPPROPRIATE SPECULATION ABOUT THAT AND OTHER INSTITUTIONS IN GENERAL. WE END UP, THEN, SUPPORTING A PRIVATE INTEREST AT THE EXPENSE OF THE PUBLIC INTEREST.

AS BANKERS YOU ARE AWARE OF THE PROBLEM SITUATIONS WHICH ARE RESOLVED THROUGH MERGER, NEW OWNERSHIP OR AN INFUSION OF CAPITAL WITHOUT ANY PUBLIC LOSS -- IN FACT WITHOUT EVEN A RIPPLE IN THE FINANCIAL COMMUNITY.

THE SUPPORTERS OF ABSOLUTE, FULL DISCLOSURE SEEM ALSO TO BE

AMBIGUOUS IN THE RESULTS THEY HOPE TO ACHIEVE. THEY SEEM TO INFER THAT FULL DISCLOSURE WILL ON ONE HAND KEEP THE BANK FROM FAILING, YET, ON THE OTHER HAND, ARGUE THAT FULL DISCLOSURE WILL KEEP THE REGULATORS FROM SUPPORTING A FAILING BANK THAT SHOULD GO UNDER. I AM CONFUSED BY THIS.

I AM ALSO DISTURBED BY THE PRESUMPTION THAT YOU WILL BE BETTER MANAGERS IF THERE WERE FULL DISCLOSURE. SOMEHOW AND FOR SOME REASON, YOU ARE RUNNING YOUR BANKS, IGNORING YOUR STOCKHOLDERS, OR, EVEN WORSE, "PULLING THE WOOL" OVER THEIR EYES. AGAIN, I AM CONFUSED BY THIS.

AS I SAID AT THE OUTSET, I DO BELIEVE THAT MEANINGFUL INFORMATION SHOULD BE PROVIDED. I HOPE THAT A CLEARER CONCEPTION OF THE RISKS AND BENEFITS WILL BE DEVELOPED. I'M CONFIDENT THAT IT WILL.

ONE FURTHER POINT ON SUPERVISION AND REGULATION, THE SUPPOSED DIFFICULTIES IN BANK SOUNDNESS HAS BEEN TRANSLATED INTO INCREASED PRESSURE FOR REGULATORY CHANGE. WHILE A CASE MIGHT BE MADE FOR AN OVERHAUL OF OUR REGULATORY APPARATUS, I DO NOT FEEL THAT A CONNECTION HAS BEEN SHOWN TO EXIST BETWEEN OUR REGULATORY STRUCTURE AND THE PRESUMED PROBLEMS. WERE THE FRANKLIN AND SAN DIEGO FAILURES A RESULT OF OUR REGULATORY STRUCTURES? I SEE NO REASON FOR ARGUING THAT. DOES THE PRESENCE OF SOME BANKS ON A SO-CALLED "WATCH LIST" SUGGEST THAT OUR COMPTROLLER, FDIC, FED AND STATE EXAMINING STRUCTURE IS FAULTY? AGAIN, I WOULD HAVE TO SAY, NO.

CERTAINLY, INDIVIDUAL BANK MANagements CAN AND HAVE MADE ERRORS. NO AMOUNT OF DISCLOSURE WILL CORRECT THAT. IN FACT, I WOULD ARGUE THAT THE ERRORS THAT HAVE BEEN MADE BY BOTH BANK MANagements AND MARKETS

HAVE ARISEN NOT FROM A LACK OF RELEVANT BANK ACCOUNTING DATA BUT FROM A MISREADING OF ECONOMIC TRENDS.

THAT TAKES ME TO THE LAST ROLE OF THE FED WHICH I MENTIONED EARLIER -- MONETARY POLICY. HERE THERE IS LITTLE DOUBT THAT THERE HAS ALWAYS BEEN A STRONG PUBLIC PERCEPTION OF THE SYSTEM'S ROLE AS BEING IN THE PUBLIC INTEREST. THE ONLY DIFFERENCE HAS BEEN THE INCREASED EMPHASIS THAT HAS BEEN PLACED ON CONGRESSIONAL OVERSIGHT. THIS OVERSIGHT HAS NOT CHANGED THE WAY IN WHICH MONETARY POLICY IS FORMULATED AND IMPLEMENTATION, BUT INCREASED OVERSIGHT HAS BROUGHT WITH IT SOME PLUSES. IT HAS REMOVED SOME OF THE MYSTERY ASSOCIATED WITH WHAT THE OBJECTIVES OF THE FED ARE AND HAS DEMONSTRATED THAT THERE IS NO BASIS FOR VIEWING THE FED'S ACTIONS AS BEING INIMICAL TO THE PUBLIC INTEREST.

THERE ARE PROPOSALS FOR FURTHER DISCLOSURE OF MONETARY POLICY DECISIONS, MANY ASSOCIATED WITH THE "SUNSHINE IN GOVERNMENT" BILLS. THE FED HAS ALWAYS TAKEN THE POSITION THAT AS MUCH INFORMATION WILL BE RELEASED AS POSSIBLE. THE ONLY LIMITATION MUST BE THOSE ITEMS WHICH WOULD TEND TO DISRUPT THE DECISION PROCESS OR DISRUPT THE MARKETS THAT ARE IMPORTANT IN THIS ECONOMY. IF EITHER IS DISRUPTED, THE PUBLIC INTEREST WOULD NOT BE SERVED.

THE FED IS NOT UNCOMFORTABLE IN THIS NEW ENVIRONMENT OF INCREASED CONCERN WITH INSTITUTIONS. IT WAS DESIGNED TO SERVE THE PUBLIC INTEREST, HAS BEEN OPERATED SO AS TO SERVE THAT INTEREST AND WILL CONTINUE TO DO SO.