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MANAGING THE CHANGE IN BANKING

Remarks by

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It is a real pleasure for me to join you here in Oklahoma City for the annual convention of the Oklahoma Bankers Association. This meeting is particularly enjoyable for me because it is among the first state association conventions I've attended since becoming president of the Federal Reserve Bank of Kansas City on March 1. Let me assure you that this gathering is just one of many I plan to attend here in Oklahoma and throughout the Tenth Federal Reserve District in coming years. I'll be meeting this way with bankers as often as possible because I firmly believe that we at the Federal Reserve should strive to improve our communication with all segments of the banking and business community—not only to convey our ideas on various policy issues, but to seek your opinions and advice on matters we may be considering at the moment.

Getting together this way to discuss and clarify the critical issues affecting banking is an important tradition for Oklahoma bankers. And this year, your concerns appear to be even more significant, given the environment of constant change in which you are operating. We all recognize that change is a powerful force in all facets of our personal and professional lives. The phenomenon of change affects every decision we make. Intelligent acceptance of change often is the key to successful integration of worthwhile new elements into our existence. Banking has certainly not been exempt from change, nor are bankers necessarily devoted to the status quo. For many bankers, change is the onset of opportunity.

The most obvious areas of change affecting financial institutions today are related to the rapidly evolving electronic funds transfer technology and the associated competitive results. Two events have spurred this far-reaching and, as yet, not fully understood medium of financial exchange. One event, of course, is the dramatic improvement in computer-based systems and their capabilities. The other, and equally important perhaps, is recognition by bankers of the market potential in expanded EFT systems, which translate into further opportunities to improve public access to banking services. In any case, many of you now discuss

matters of EFT, ATM's, CBCT's, and POS as readily as you talk about lending policy or investment strategy. Electronic banking is here and many of you already are working on plans to utilize the new technology for expanded services for your customers and perhaps even penetration into untapped markets.

At the Federal Reserve Bank of Kansas City, we've been interested to note that many EFT-related developments have originated and are continuing to occur here in the Tenth District—the heartland of America. And you Oklahomans have been right in the forefront of innovation. Not only that, the legislation you considered, developed, and passed this year demonstrates what I call managed change. In this case, managed change meant a balancing of technological, regulatory, and legislative forces in a manner which provides a potential long-term benefit to the Oklahoma public.

The new Oklahoma law allowing banks to establish remote EFT facilities anywhere in the state is an excellent example, I believe, of orderly change brought about in response to market developments and regulatory and legislative decisions. Of course, Oklahoma bankers had been considering EFT matters for some time, so you were well prepared for the deliberations on the new legislation. I believe that you are to be commended for producing a law which is equitable, relatively free of regulatory hassle, yet which has achieved the objectives of both bankers and legislators by permitting expanded customer services while maintaining the essential features of the unit banking concept. This change in your environment was managed, in the best meaning of the term.

As Oklahoma banks and consumers reap the advantages of this marriage of technology and market opportunity, as new services come on line for your customers, other fundamental issues will arise, issues which will put to the test your process of orderly response to change.

For example, under regulations now in place, the demise of demand deposits as we know

them may well occur with increasing speed. With electronic access to their various accounts with you, consumers may well take advantage of the opportunity to transfer funds frequently—even several times daily—from their savings to their demand accounts for bill paying purposes. In the long run, this development might really mean that you will be paying interest on what are essentially demand accounts. Won't that mean a higher cost of funds for you? How will you continue to offer the same level of service for your customers at the same price? Who will pay your increased cost of doing business? At the heart of the matter, of course, is the question of what will happen to your earnings, particularly during the transition to electronic technology, and thus, your ability to generate capital for future growth.

Other issues must also be faced. Because reserve requirements on savings deposits are lower than on demand deposits—and quite a bit lower for larger member banks—what will be the relative impacts on banks' lending or investment capacities? A related question is concerned with the impact of shifts from demand to savings accounts on the ability of the Federal Reserve to conduct an effective monetary policy. Policy might become more difficult to implement if a smaller proportion of the nation's banking resources is under direct control of the central bank.

Another issue is related to the traditional people-oriented character of banking services. Your marketing plans generally have stressed the development of continuing personal and business relationships with your customers at many points in your service structure. The new electronic banking technology, however, is essentially an impersonal one. How will you retain the warm, personal flavor of banking relationships in a push-button environment?

These questions and their implications deserve much careful study. In Oklahoma, your demonstrated dedication to managed change in banking will undoubtedly be helpful as these issues come to the front. Application of the same thoughtful, orderly approach to the new and unforeseen

problems of electronic banking undoubtedly will help soften some of the potentially troublesome impacts.

Unfortunately, we have not witnessed the same type of careful management of change on the national scene this year, as matters of financial restructuring have proceeded in Congress. It is true that the groundwork for this current attempt at change was laid in the late 1960's when the Hunt Commission began its work. The Commission brought forth a package of financial restructuring affecting all institutions and regulators. It was a comprehensive set of recommendations considered and developed in a free and open manner by a group owing allegiance only to the public interest.

Following the lead of the Hunt Commission, the Administration and Congress had adopted the deliberate approach to financial restructuring in recent years and it is difficult to fault procedures or intentions. But the more recent legislative actions, especially the emphasis by some in Congress on getting something passed by mid-1976, leaves me concerned over the kind of legislation that may be forthcoming. As you all know, the so-called "financial reform" legislation of 1976, is comprised of three bills: the Financial Institutions Act, the International Banking Act, and the Federal Reserve Reform Act.

There is no doubt in my mind that significant change is warranted and that timing is also essential in response to the massive market changes of the past few years. However, the nation can ill afford to see some legislation rushed through just to meet an arbitrary deadline. While I do not necessarily concur with all the findings in the Hunt Commission Report, I feel that one of the essential elements in the Report was the breadth of the change suggested. Again in the FINE hearings, a broad range of issues were considered together as a result of what I interpreted as a necessary linking of some very complex issues. At the last minute, it appears that these issues were separated for simple political expediency—to increase the likelihood of at

least one bill passing. And there was almost no consideration given to the potential effects of this piecemeal approach to proposed reform. I am wondering now what changes in the existing legislation would be permitted in the name of further expediency. Again, the need for a thoughtful, managed change is evident more than ever if the result is to be a balancing of technological, regulatory, and legislative forces to provide increased services to the public in a relatively stable, competitive environment.

Many of you will agree that the recent proposed changes in the financial structure were not being "managed" in the sense I have outlined. And many of you communicated quite well to your representatives in Washington that the recent attempt at reform legislation was an erratic package which would be detrimental to commercial banking and the interests of the nation. It is in the best tradition of our representative political processes that many of you voiced your concern that the financial reform legislation, if passed, would have an adverse impact upon the whole economy, with particular effects on charges to consumers for bank services. Further, many of you believe that such legislation could lead to political allocation of credit, and you said so.

As you all know, the Federal Reserve also has been under attack this year. These attacks were incorporated recently into the "Federal Reserve Reform Act" I noted earlier, which, incidentally, was passed in the House on Monday in a diluted form. Had this measure passed as originally proposed, it would have struck at the very heart of the traditional independence of the Federal Reserve System. Supporters of the legislation claimed that it would "democratize" the System. On the contrary, I believe that it would have "politicized" the System and perhaps have created a dangerous situation for our economy by bringing the process of monetary policy formulation under political control.

On this issue, I think it's important for the Federal Reserve's position to be clearly understood. We are, of course, a public institution, created by Congress and delegated the important responsibility of managing the country's money supply. Being a public institution, we fully recognize that the Federal Reserve must be responsive to the wishes and long-run best interests of the American people. And, I believe, we have lived up to that responsibility in a creditable manner. In this broad sense, therefore, the Federal Reserve has been—and should continue to be—responsive to the political process in America.

The basic intent of the early versions of the Federal Reserve Reform Act, I believe, was not consistent with this broad interpretation of political responsiveness. Rather, it seems the intent of the proposals was to subject the monetary policy process to the short-run influence of partisan political pressure. Responsiveness to this type of political pressure is, of course, contrary to the original design of the founders of the Federal Reserve System and contrary to the best interests of the American public.

The Federal Reserve System, as it was originally designed and as it has evolved over the years, is characterized by two key elements which have allowed it to conduct monetary policy independently of partisan political control. One is that the Federal Reserve Act specifically isolates the monetary policy process from potential short-run political influences. For example, the members of the Board of Governors—all of whom participate in monetary policy decisions—are appointed for long terms. Similarly, the presidents of the twelve Reserve Banks—who also participate in monetary policy—are appointed for relatively long terms and their appointment process is conducted outside of the political arena. Furthermore, the System is by and large self-financed so it doesn't have to come hat-in-hand to Congress each year for operating funds.

The second key element of the System is that it is a decentralized central bank. The

responsibility for formulating and conducting monetary policy is widely dispersed throughout the country. The Board of Governors in Washington plays an important role but so do the twelve regional Federal Reserve District Banks. Since the presidents of these banks participate directly as voting members of the Open Market Committee, the varying needs and economic interests of each of the different regions can be represented in the policy process. The decentralized system also specifically allows for independent views to be brought to bear. Such views are obtained from the Boards of Directors of each District Bank—who are drawn from within each region—from independent economic research, and from direct Reserve bank contact with local bankers and businessmen.

The decentralized nature of the System, in my opinion, is one of our primary sources of strength. It has enabled the System to be responsive—in the most direct and broadest sense—to the wishes of the American people of every region. At the same time, it has prevented the monetary policy process from being controlled by a narrowly-based group of individuals, whether located in Washington, D.C., or elsewhere. In other words, the decentralized nature of the System embodies the traditional unwillingness of the American people to tolerate any undue concentration of economic and financial power.

The disturbing feature of the original proposals in the "Federal Reserve Reform Act" is that they would have undermined the independence and the decentralized nature of the System. If we were to politicize the monetary policy process through such legislation this year or any year, I believe the dangers to our economy would be extremely serious. As an example, the early proposals in this recent legislation would have provided for the appointment of Reserve Bank presidents by the President of the United States, subject to Senate confirmation. The proposal also would have removed the current Reserve Bank presidents as voting members of the Open Market Committee until Presidential reappointment, which would not have occurred until

1981. Such action taken anytime would seriously undermine the representative and independent nature of the monetary policy process. If this legislation had become reality, and Reserve Bank presidents became directly responsible to members of Congress, the exclusive franchise to create money vested in the independent Federal Reserve System would be effectively passed into the hands of those who also have the authority to spend money.

Economic history is replete with clear lessons of what happens when the "money creating" process in a nation is taken over by political forces. Initially, more money is created to finance politically desirable projects; then inflation takes over; followed by the printing of more money. Inevitably, rampant inflation so weakens the financial structure that the economy collapses, and very often so does the political structure as well.

For this reason, I was not in favor of so-called "reform" proposals embodied in the recent legislation. This is not to say, however, that changes in the System should not be explored and adopted. The Federal Reserve must always be receptive to changes that would improve its organizational structure, widen its perspective, and allow it to continue to be responsive to the broad wishes of the American people. For example, I would encourage full and open debate about the Federal Reserve's role as a bank regulator, or about its function in the developing EFT structure. However, I believe that any changes that would jeopardize the independence of the System in its conduct of monetary policy, or would weaken the regional and decentralized nature of the System, would be economically unsound and accordingly not in the best interests of the American public.

And just as I believe that change in banking must be managed in a clear and goal-oriented manner, I also believe that change proposed for the Federal Reserve must reflect the same thoughtful, managed character if the Federal Reserve System is to continue to be effective as an essential institution in American society. Even if logic prevails in 1976, and

the erratic legislative proposals affecting financial institutions and the Federal Reserve are defeated, diluted, or delayed, we must be vigilant next year, and the next, so long as forces are at work which would bypass the more deliberate evolutionary process represented in the principle of managed change.

As the issues of change in our financial structure—and the inseparable issue of technological impacts—are discussed in national forums in coming months and years, I know that knowledgeable bankers will continue to draw upon their experience to counsel their lawmakers and regulators. I, for one, am hopeful that our legislators will consider fully the traditional principles of free enterprise in their decisionmaking. Let them establish a financial structure where all like institutions can compete equitably. Let them provide reasonable equity in requirements for capital, for liquidity, for taxation. Let the marketplace decide what institutions should provide what services and at what prices. I am confident that America's bankers would welcome the opportunity to place their wide experience and commitment to public service on the line and take their chances against all comers in the competitive arena.

In closing, I want to say that as inevitable change does occur in banking, we at the Federal Reserve Bank of Kansas City intend to work with you to accommodate this change, to manage it for the preservation of the finest financial system in the world. As we consider these matters, and as we deliberate about monetary policy and other policies affecting banking, business, and the public, I know that I—like my predecessor George Clay—will be able to call upon my Oklahoma banking friends for advice, assistance, and support.

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