Remarks

By

E. Gerald Corrigan

President

The Federal Reserve Bank of Minneapolis

American Bankers Association Annual Convention

Atlanta, Georgia

October 19, 1982

It is always a pleasure to join the membership of the American Bankers Association at your annual convention. I find that in any meeting with bankers I attend these days--whether an informal breakfast with a handful of small agricultural bankers on the outer reaches of the Ninth Federal Reserve District or here in Atlanta with the bankers of the nation--two subjects are universal: monetary policy and deregulation. Both are complex and controversial and, to my mind, closely related. This afternoon, however, I would like to focus my opening remarks on the deregulation issue itself and leave monetary policy and the interrelationships between the two for another time.

While I am not surprised by the frequency and, at times, the intensity with which the subject of deregulation comes up in my discussions with bankers, I am struck by the fact that the term means very different things to different people. To some it offers the possibility of achieving the promised land. At the other extreme, it reduces to the single-minded proposition of letting markets and individual private institutions do their thing, come what may. That sentiment, no matter how appealing, must have limitations, even in industries like trucking. And, if there are limitations in trucking, surely there must be in banking.

In short, I think we can all agree that the real issue is not deregulation but rather it is finding the appropriate balance of regulation that will permit banking organizations to function effectively in a marketplace that is increasingly cluttered with new sources of competition. Striking that balance seems to me to require that we pause a bit and ask ourselves hard questions about what banks are and what we want them to be.

Historically, that question was not all that difficult to answer. Banks were intermediaries; they used their charters and their unique deposit taking and deposit creating powers to assemble financial resources and to make them available to others in the form of loans and investments. The deposit taking function, in particular, made banks very special institutions for it involved--and still does--a level and a degree of fiduciary responsibility and public trust that set banks apart even from other financial institutions. History has also shown that banks are different in another way. That is, public trust and confidence in individual banking organizations--at some point--is only as strong as is public trust in the banking system as a whole. Only recently we may have had a small illustration of this phenomenon when many bank stock prices reacted, at least in part, to the problems associated with the Drysdale situation.

In any event, and at the risk of an oversimplification, it seems to me that these characteristics of banks constitute the basic reasons banks are regulated and why, in my judgment, they will always be subject to a heavy dose of regulation relative to other classes of institutions. That proposition, I suspect, is not one that is subject to great debate. But, even if we can agree on that point, the perception and the reality of excessive regulation of banks would remain. You would say, for example, that many of our current banking regulations have little or nothing to do with the needs of monetary policy or with the safety and soundness of banks or of the banking system. In addition, you could make the point that the nature of banking and its position on the competitive landscape have changed to the point where much of our current regulatory apparatus is self-defeating in that it pushes traditional "banking functions" into nonregulated or less regulated firms or locations, thereby frustrating bankers and frustrating the objectives of the regulations.

Both of these arguments, I will readily confess, have some validity. For example, it would seem that the legislative process has superimposed certain specific social goals and objectives on to the bank regulatory process. Truth in Lending and Community Reinvestment may be cases in point. Indeed, I would venture the guess that many of the regulations that you view as most onerous and costly have their roots in the legislative, not the regulatory process. To that extent--and I believe this distinction is important--the problem is not so much one of regulation as it is one of legislation.

Legislation does not, of course, occur in a vacuum. It occurs because the Congress perceives a need or a problem. In this light, I think it is also important to note that still others of our banking regulations grew out of relatively isolated situations involving poor management, poor practices, or both. I have in mind here something like FIRA. In these unhappy situations, I think it is obvious that all of us--bankers, regulators, and the society at large--end up paying a price--a high price-- for the real or preceived transgressions of a few. There is another more subtle way in which excessive regulation may occur. Take, for example, areas such as capital guidelines or reserve requirements, where I think we can all agree on the need for some form of regulation. The regulator makes policy and the technocrats write Federal Register notices with the virtual certainty that at least a few high-priced banking attorneys will--within hours of publication--be hard at work seeking ways to avoid the regulation or to stretch their institutions' practices to the very limit of the regulation's exact language. That tendency --with its competitive implications--results in a Catch-22 of complex regulations, interpretations, and more regulations. Here too, the burden falls not just on those who would "play the game" but on all participants--particularly smaller institutions that typically have neither the expertise nor the inclination to get caught up in these vicious circles.

The second element of the regulatory conundrum I referred to earlier essentially grows out of the fact that the financial intermediation process is no longer--if it ever was--the exclusive domain of banks or even of depository institutions more generally. Since every action surely does produce its own reaction, small and large banks responded to this situation by altering their strategies and practices and by reaching out to provide new services, to establish new relationships, and to obtain new powers--all in the interest of achieving that mythical level playing field. These strategies, while understandable, raise questions as to how far and how fast we want to go. Here, I have a hunch I may be a bit more conservative than many of you--including perhaps my fellow panelists. Don't misunderstand me. I want a flourishing, healthy banking system fully as much as you do because, in my view, that flourishing banking system is essential to a flourishing economy. The point is not whether you or I want a vital, growing, and competitive banking system. The point is to bring about needed change and reform in a way that complements rather than frustrates that objective.

To me, that implies a continuing need to be sensitive to the historical distinction between banking and commerce, to be sensitive to the legitimate needs of monetary policy, and--perhaps above all--to be sensitive to safety and soundness considerations. We must remember that banking defies a fundamental theorum of elementary geometry: the sum of its parts are greater than the whole. That is, if an individual bank, by design or default, places its shareholders in jeopardy by assuming too much risk or by poor managment, that bank should--along with its other freedoms--be free to fail. But, banks are not shoe stores! Systemic weakness in banks can and must be avoided and the regulatory/legislative framework and agenda for the future must be formulated with that in mind.

If those are some of the things that are important to me--and I include achieving a greater degree of competitive equality for banks on my list--let me conclude with a few observations on where I would like to see things go from here. In doing this, let me emphasize that these views are my own and may not necessarily be shared by other Federal Reserve Bank presidents or the Federal Reserve Board.

First, I think we must decide whether particular social objectives are best realized via banking legislation and regulation. The point is not whether Truth in Lending and Community Reinvestment make sense or whether they are desirable; the point is how those goals are best achieved and whether giving banking regulators authority to achieve those goals so muddies the waters of banking regulation as to undermine both objectives. Put bluntly, do we want bank regulators to be agents of specific social changes? My answer is No.

Second, I believe that individual banks and bankers must more fully recognize that their own actions can and have contributed to the regulatory problem. Real or preceived abuses, as few as they may be, will inevitably produce pressures for more regulation and more legislation. Similarily, respecting the spirit of necessary regulations, rather than stretching practices to or beyond the very limit of those regulations, would seem to me be in your best individual and collective interest.

Third, I believe we as regulators must be more willing to search out and fix problem situations. This may seem to be at odds with the current vogue of "letting the market do its thing" or "getting government off our back." But, I don't see it that way. I would argue that by moving more quickly and decisively on individual problems we will reduce the burden of regulation and legislation for banks as a group and place more of the burden on those individual institutions that, by virtue of their behavior, warrant that extra margin of supervisory attention.

Finally, I believe we should get on with the task of providing banks with broader powers, thereby achieving more equitable competition between banks and their new sources of competition. To do that, I suspect we all must come to a better understanding of what it is we want banks to do--recognizing, at least from my perspective, that they cannot be and should not be all things to all people. I support the concept of a bank as a financial supermarket, but I don't want a used car department in the supermarket. By the same token--and to take the extreme case--I don't want the used car dealer in the deposit taking business either. The conventional wisdom suggests that the basic solution to this problem is to deregulate banks, certainly not to extend regulation to others. On the face of it, that seems reasonable, and that is the direction in which we are and should be moving. However, today's conventional wisdom may not fit tomorrow's realities. We need at least to keep that in mind.

I said earlier that I might be a bit more conservative on some of this than are many of you. That may be, but don't mistake my essential message. I think we are on the right track. Staying there is what I am concerned about.

Thank you.