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THE STRUCTURE OF BANKING TO COME

Remarks by

Hugh D. Galusha, Jr.
President
Federal Reserve Bank of Minneapolis

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Hugh D. Galusha, Jr.

The ideas I am going to share with you today are poor things but mine own. This general disclaimer is for the protection of John Kareken, who serves as my private chaplain, and the distinguished staff of the Minneapolis bank.

Nor do they reflect what I consider to be the optimum model -- to the contrary, some of the constraints shaping American banking are quite distasteful to me, but they cannot be wished away. As the Chairman is wont to say, we start from a point on a moving stream that commenced quite a ways back -- or to use another metaphor, we are looking at a game already in process with no opportunity to call king's X so we can sort out the players and establish the rules.

If there is a single word to characterize American banking today, it is disparate; for some associated with American banking, like the Federal Reserve System, it might almost be pronounced desperate, as well. The banking industry is hardly a monolithic structure. There may have been a day when the First National Bank of Helena, Montana, and the First National Bank of New York differed principally in scale; but the difference between the First of Helena and Citibank in 1967 is almost one of essence. Functions have been added to the bank in the major urban center in bewildering succession. Even the merchandise has been altered as the search for new sources of supply and new sales packaging continues to accelerate.

What is appropriate for a bank to do within the legal limits of a corporate charter, a body of statutory proscriptions, a pattern of regulation by agencies that have been around a long time, should be easy for reasonable men to define. Certainly it presented no difficulty to Mr. Saxon, to mention one. But for the rest of us who see things less clearly, the definition of a bank becomes more and more difficult, compounded as it is by the extraordinary fertility of imagination of the current generation of bank management to be found in the first three hundred or so of American banks arranged by size.

Illustrative of the point are a number of suits pending against banks by other industrial and occupational groups whose bailiwicks have been invaded by hungry bankers. Computer service bureaus and travel agents are two that come to mind.

Essentially these ventures into new areas have been responses to market forces spurred on by pressures to maintain and expand profit margins. In general, they have been phenomena of the money centers, with only a partial osmosis to banks away from these centers. And for a good reason. Scale itself has been one of the major divisive forces working to alter the essence of these 14,000 enterprises lumped together loosely and inaccurately as banks. The accommodation of a major U. S. industrial customer -- say, one of the Fortune 500 Club -- is a far more complicated response than that required by Main Street. This has affected the lending patterns obviously; but more importantly it has forced the large bank to develop management expertise and knowledge within the narrow context of each of these major industries. The roster of officers and their disciplines

at the Chase, for example, is almost as long and complicated as the catalog for the Harvard Business School.

And the hardware of banking -- here also, capital and entrepreneurial skill have forced a cleavage between the large and the small. The computer may turn out to be the instrument that forces aggregative banking in some form. Not only may this flow because the surrender of the bank record-keeping process can lead to an abrogation of the decision-making process, but because of customer demand for computer services the small bank cannot satisfy.

I could continue. Trust services, which are becoming very sophisticated indeed at the largest banks; portfolio management; the handicaps of geography and scale again which preclude the small bank from sources of funds which are not accessible to it either because they are not there, or the holders lack the requisite sophistication which must be present to make them usable.

My first point then is that the gap between the small bank and the large bank, caused by internal and external market forces, will continue to widen -- a gap possessed of many more elements than scale alone.

As bank customers become more sophisticated outside the great urban centers, they will demand types and quantities of services the small independent bank cannot -- or will not perform. I think back on my experience representing what were in the main small businesses. Those that grew and became in succession part of regional and then national corporate groups usually changed their banking connections, shifting to successively larger banks as they went.

There may always be a market for the services of the small bank, but my guess is this will be a market of small businesses and personal deposit and loan services.

I say this because I see no way within the present structure of American banking for it to be otherwise. The correspondent banking system is hardly operating to enlarge the role of the small bank, as Mrs. Nichols of the Chicago Fed confirms in her excellent study of the correspondent system.

It might be argued that the market place may force the small unit bank to seek some other form of accommodation than the correspondent system. I can only guess at an answer -- but my guess is that it will. Intra-state holding companies, branch banking -- even banking consortiums like the service companies now permitted in some states are possibilities. The small bank cannot indefinitely continue to abrogate functions to his city cousin without some atrophy of banking skill, opportunity, and disillusionment of his market. It would be unfair not to mention the efforts being made by some banking associations to provide training and information programs designed to overcome some of the disadvantages of scale suffered by the small bank. But my guess is that the capital differences still remain.

So to my second point -- the big banks are going to get much bigger; smaller banks -- and here I am correlating them with the small town -- are going to show a much slower rate of growth -- with a step up in aggregative banking experimentation.

Society, in its endless preoccupation with what is good and desirable, has always been concerned with the flow of money and credit, but until fairly recently the mystique surrounding American banking kept the public interest at a reasonable distance. But a generation of aggressive advertising -- "your friendly bank"....."we're here to help you get what you want"....."one stop banking"....."your full service center" -- has had its effect. Congress

and legislatures now regard a bank as possessed of no more mystery than the local A & P. In fact, the suspicion is growing in some quarters of Washington that banking is too important to be conducted by bankers.

Not only by their own advertising, but in part by their conduct, bankers have fueled this suspicion. They have hardly distinguished themselves in the last twenty-four months by their willingness to put public interest above their own. Again, they have been victims of their own image -- in their efforts to stress service to the public, they encouraged expectations that could not be realized. Banks exist, as far as owners and management are concerned, to make a profit. Period. And only if they make a profit can they attract management and capital. Ideally, this means it must be their judgment, in the main, where and how they obtain funds, and where and for how much they loan these funds. It also means they -- or at least the creative ones -- will always be searching for new ways to make a buck.

More and more often these essentially private enterprise objectives are colliding with social goals set by legislatures and Congress -- not to mention those set by extension by regulatory agencies. So I come to my third point -- national and local objectives -- social goals -- are going to alter, at an increasing rate and in significant ways, the American banking system. Examples:

- · Difficult as it is now to define a bank, the problem will be infinitely complicated by the changes proposed for S & Ls.
- The cost of money on both sides of the equation will continue to be regulated, and my guess is the tolerances will be narrowed as the years go by.
- U. S. based banking corporations will find their overseas operations subjected to increasing U. S. control.

More legislatures are going to grapple with such thorny problems as non-par banking, branching, out-of-state ownership, interest ceilings, regulatory machinery -- and who knows, there may be other states than North Dakota experiment with their own central bank.

But it is with the allocation of funds the major public concern will be manifest. This country is in the throes of a social revolution, the implications of which have hardly commenced to surface. Whether they be in the ghetto or in rural America, the disadvantaged -- the losers of our society -- are making themselves heard.

Charismatic industries like outdoor recreation and agriculture have their own vocal constituency. Some of these programs are even designed to redistribute population and industry. This they have in common: all of these are massive programs involving billions of dollars; all will affect the allocation of funds in the U. S. banking system. And here is the reason the public sector will have to intervene, once the determination has been made that the investment goal of a new tenement, a recreation complex, or industrial jobs in rural America, is a socially desirable one: with few exceptions, most of the situations are submarginal credit risks within the conventional banking framework -- especially when viewed competitively against the alternatives available to the banks with the requisite credit capacity. If society desires the goal, seed capital at least will have to be provided by society.

I have no idea how these demands will affect the U. S. banking system. Some certainly will be met outside. For example, I happen to think U. S. banking is in the same relative position to the Farm Credit System and U. S. agriculture as it was a few years ago to S & Ls^{and} residential lending. There will be primary credit programs -- current alternatives in outdoor recreation financing, plus those of the five or six bills in

Congress now, are typical. There will be guaranty programs, participation programs, moral suasion, tax gimmicks -- the possibilities are endless. But they will come. Social pressures are simply too great to be contained for long -- even with the Viet Cong sitting on the safety valve.

The Fed will be at the interface, as the hep bureaucrats now put it. For us to say the Federal Reserve System cannot or should not be concerned with social goals is ridiculous. We owe our very existence to such a national objective. Look at the way the Board has been flailing about in the holding company and merger cases. Bigness, concentration of markets and ownership -- these bundled together make up the factor of competition which has been by far the most equal among the five equal factors listed in the holding company act. Right or wrong, this is a social determination -- a reflection of the national concern with the structure of the economy. Introspective efforts like the discount study reflect the deep concern within the System that we always be responsive to changes in the economy. And we must acknowledge the special view taken of us by our parent, the U. S. Congress. When they were looking for a place to tuck truth in lending, it is hardly an accident we were named. In the agonizing to come over the control of the electronic network that one day will not only be the courier of our credit, but the repository of all our secrets, Congress may well rely on our vaunted independence and objectivity, and add it to our list of responsibilities.

This journey started on Christmas Day, 1913, and I'm glad to report, at this stage of my short career with the Federal Reserve System, that the end is not in sight. As a confirmed wild river runner, in a humanist sense as well as a physical one, I can hear the familiar and exciting sound of rapids around the bend. I don't know what they will be, but like most of you, I wouldn't get out of the boat if I could.