

IMPROVING THE REGULATORY ENVIRONMENT

BY

DAVID P. EASTBURN, PRESIDENT
FEDERAL RESERVE BANK OF PHILADELPHIA

NEW JERSEY BANKERS ASSOCIATION
DIRECTOR-MANAGEMENT CONFERENCE
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BANKING HAS BEEN A HEAVILY REGULATED INDUSTRY FOR A LONG TIME. IT IS THE LIFE BLOOD OF THE ECONOMY AND SO A WATCHFUL EYE AND HEAVY HAND BY GOVERNMENT ARE TO BE EXPECTED. BECAUSE OF ITS PIVOTAL POSITION BANKING ALSO HAS BEEN A PRIME CANDIDATE TO EFFECT SOCIAL AND ECONOMIC CHANGE. WHEN GOVERNMENT BECAME CONCERNED ABOUT EXCESSIVE STOCK MARKET SPECULATION IN THE 1930's, FOR EXAMPLE, MARGIN REQUIREMENTS WERE IMPOSED. IN THE 1940's AND 50's, THERE WAS CONCERN ABOUT THE OVER-EXPANSION OF CONSUMER SPENDING AND REAL ESTATE BUYING AND WE GOT REGULATIONS W AND X. IN THE 1960's AND 70's, THE FOCUS HAS SHIFTED TO CONSUMER RIGHTS AND WE HAVE TRUTH-IN-LENDING, EQUAL OPPORTUNITY IN CREDIT, FAIR CREDIT BILLING WITH MORE TO COME.

THE CONSUMER MOVEMENT IS A BROAD SOCIAL FORCE THAT IS BIGGER THAN BANKING, BUT BANKERS ARE CAUGHT UP IN IT LIKE THE REST OF SOCIETY. THE BASIC GOALS OF EQUALITY OF OPPORTUNITY AND FAIRNESS OF TREATMENT ARE HARD TO QUARREL WITH AND BANKERS SHOULD AVOID THE IMAGE OF DOING SO. THE REAL JOB OF BANKING IS TO HELP MAKE CREDIT REGULATIONS REALISTIC AND PRACTICAL. I'M ENOUGH OF A REALIST TO KNOW WE'LL ALWAYS HAVE CONFLICT AND PROBLEMS IN THE REGULATION AREA, BUT I'M ALSO OPTIMISTIC ENOUGH TO BELIEVE THAT WE'VE LEARNED SOMETHING FROM RECENT EXPERIENCE THAT WILL HELP US DO BETTER IN THE FUTURE.

EXISTING PROCESS

TO ILLUSTRATE SOME OF THE LESSONS WE'VE LEARNED, LET ME TAKE

ONE RECENT REGULATION--EQUAL CREDIT OPPORTUNITY--AND TRACE ITS DEVELOPMENT.

IN RECENT YEARS WOMEN WERE INCREASINGLY CLAIMING THAT CREDIT WAS BEING DENIED THEM UNFAIRLY. IF A WOMAN WAS MARRIED, HER HUSBAND'S SIGNATURE WAS USUALLY NEEDED TO OBTAIN CREDIT AND HER INCOME WAS HEAVILY DISCOUNTED IF SHE WAS OF CHILDBEARING AGE. IF A WOMAN WAS DIVORCED, SHE USUALLY DID NOT HAVE ACCESS TO CREDIT EVEN IF SHE HAD HER OWN INCOME. TYPICALLY, BANKERS DID NOT RECOGNIZE ALIMONY AND CHILD SUPPORT AS INCOME.

IN A SOCIETY IN WHICH THE ROLE OF WOMEN IS CHANGING RAPIDLY, INEVITABLE PRESSURES BUILT UP. ORGANIZED WOMEN'S GROUPS PRESSURED CONGRESS TO END THIS SORT OF DISCRIMINATION. CONGRESS CHARTERED THE NATIONAL COMMISSION ON CONSUMER FINANCE TO REVIEW ALL CONSUMER LENDING PRACTICES. FOUR YEARS AGO THE FIRST HEARINGS WERE HELD ON THE SUBJECT OF EQUAL CREDIT OPPORTUNITY. TO MAKE A LONG STORY SHORT, MANY WITNESSES ARGUED THAT DENYING CREDIT SOLELY ON THE BASIS OF SEX OR MARITAL STATUS WAS WRONG. THE COMMISSION RECOMMENDED TO CONGRESS THAT THIS TYPE OF DISCRIMINATION BE ENDED. AS A RESULT, LEGISLATION WAS INTRODUCED INTO THE HOUSE TO END DISCRIMINATION IN CREDIT ON THE BASIS OF SEX OR MARITAL STATUS. DURING THE CONGRESSIONAL HEARINGS, BANKERS WERE ASKED TO PROVIDE INPUT. BANKERS RESPONDED ONLY IN A LIMITED WAY. INPUT CAME MOSTLY FROM LARGER BANKS; SMALLER BANKS-- WHICH WERE TO BE EQUALLY AFFECTED--RESPONDED HARDLY AT ALL. IN OCTOBER 1974, THE PRESIDENT SIGNED A BILL WHICH EMPOWERED THE FEDERAL RESERVE TO WRITE THE REGULATION WITHIN ONE YEAR.

WRITING SUCH A REGULATION IS A DIFFICULT TASK. WITH EMOTIONS RUNNING HIGH, IT'S A REAL CHALLENGE TO BALANCE THE IDEAL WITH THE WORKABLE. THE FIRST STEP WAS FOR THE BOARD OF GOVERNORS TO DEVELOP A DRAFT FOR COMMENT. IN PREPARING THE DRAFT, THE BANKING COMMUNITY AGAIN DID NOT RESPOND IN BROAD-BASED FASHION; MOST OF THE INPUT CAME FROM BIG BANKS. AT THE COMMENT STAGE, MORE INPUT FROM BANKERS OF ALL SIZES WAS OBTAINED. WE KNOW BECAUSE THE PHILADELPHIA RESERVE BANK HELD EXTENSIVE DISCUSSIONS WITH BANKERS--LARGE AND SMALL--WHICH FORMED THE BASIS FOR A NUMBER OF CONSTRUCTIVE COMMENTS.

FINALLY, THE FED PUT THE EQUAL CREDIT OPPORTUNITY REGULATION INTO EFFECT LAST OCTOBER IN THE FORM OF A NEW REGULATION B. THERE FOLLOWED AN EXTENSIVE EDUCATIONAL EFFORT ON OUR PART TO HELP BANKERS COMPLY. WE PARTICIPATED, FOR EXAMPLE, IN MANY SEMINARS THROUGHOUT THE THIRD DISTRICT. OUR BANK SERVICES AND REGULATIONS PEOPLE HAVE HAD NUMEROUS INDIVIDUAL CONTACTS WITH BANKERS TO HELP THEM COMPLY.

WHAT HAVE WE LEARNED?

WHAT HAVE WE LEARNED FROM THIS AND SIMILAR EXPERIENCES? I SEE FIVE LESSONS:

1) BANKERS NOT RESPONSIVE. THERE IS CONSIDERABLE VALIDITY TO THE VIEW THAT BANKERS HAVE NOT ADJUSTED READILY AND VOLUNTARILY TO SOCIAL CHANGE. IT HAS BEEN CLEAR FOR SOME TIME, FOR EXAMPLE, THAT THE ROLE OF WOMEN IN OUR ECONOMY HAS CHANGED. FORTY PERCENT OF THE WORK FORCE ARE WOMEN. THEY'RE DOCTORS, LAWYERS, EXECUTIVES, COLLEGE PROFESSORS AS WELL AS CLERKS, TELLERS AND TELEPHONE OPERATORS. DIVORCE IS MUCH MORE COMMON THESE DAYS. FOR EVERY TWO MARRIAGES

THERE IS ALMOST ONE DIVORCE. THE OLD RULES OF CREDIT--BASED ON SOCIAL CONDITIONS OF ANOTHER GENERATION--SIMPLY COULDN'T LAST. YET, MANY BANKERS HELD ON TO THE OLD WAYS UNTIL FORCED TO CHANGE. HOW MUCH BETTER IT WOULD HAVE BEEN TO HAVE BEEN MORE ALERT AND MOVE WITH THE TIMES RATHER THAN BEING SHOVED. SO, THE FIRST LESSON IS FOR YOU AS BANKERS TO BE MORE ALERT TO THE ENVIRONMENT IN WHICH YOU SERVE CUSTOMERS.

2) BANKERS NOT PARTICIPATING. THE SECOND LESSON IS THAT BANKERS HAVE NOT PARTICIPATED ENOUGH IN A POSITIVE WAY WHEN LEGISLATION AND REGULATIONS ARE BEING DRAFTED. WHAT PARTICIPATION THERE IS MORE OFTEN COMES FROM BIG BANKS WHOSE OPERATING AND MARKET CHARACTERISTICS CAN BE QUITE DIFFERENT FROM MEDIUM- AND SMALL-SIZE BANKS. I KNOW THAT ONLY BIG BANKS HAVE THE STAFFS AND KNOW-HOW TO PARTICIPATE. YET, THE REST OF YOU CAN ILL AFFORD NOT TO PARTICIPATE. YOUR INDUSTRY ASSOCIATIONS CAN PLAY A MAJOR ROLE IN SEEING THAT THE VIEWS OF SMALL-AND MEDIUM-SIZE BANKS RECEIVE THE SAME ANALYTICAL SUPPORT AS THOSE OF THE BIG BANKS. YOU SHOULD FEEL FREE TO USE US AT THE FED. WE ARE AVAILABLE TO WORK WITH THE NEW JERSEY BANKERS ASSOCIATION AND ITS FEDERAL RESERVE RELATIONS COMMITTEE TO MAKE CERTAIN THAT THE PROBLEMS OF ALL SIZES OF BANKS ARE BROUGHT TO THE FORE WHEN REGULATIONS ARE BEING WRITTEN.

3) COST OF REGULATIONS. THE THIRD LESSON IS THAT REGULATIONS ARE COSTLY. WITH THE HELP OF FIVE NEW JERSEY BANKS, REPRESENTING A CROSS SECTION OF BANKS IN THE STATE, WE HAVE PUT TOGETHER SOME ROUGH

ESTIMATES OF WHAT IT COSTS A BANK TO COMPLY WITH THE EQUAL CREDIT OPPORTUNITY AND FAIR CREDIT BILLING REGULATIONS. FOR THE BANKS IN OUR SAMPLE, THE COSTS INCURRED IN COMPLYING WITH THESE TWO NEW REGULATIONS AMOUNTED TO BETWEEN ONE AND TWO PERCENT OF NET INCOME IN 1975. ROUGHLY HALF THE OUTLAYS WERE ONE-TIME COSTS OF MEETING THE REQUIREMENTS OF THE NEW REGULATIONS, INCLUDING TRAINING TIME FOR OFFICERS AND STAFF, LEGAL FEES, COMPUTER PROGRAMMING AND PRINTING COSTS. PRINTING COSTS VARIED FROM \$3,000 TO \$13,000 PER BANK, DEPENDING ON THE INVENTORY OF SUDDENLY OBSOLETE FORMS.

RECURRING COSTS, SUCH AS ADDITIONAL ONGOING SALARY EXPENSES, INCREASED TIME SPENT IN EXPLAINING REASONS FOR THE DENIAL OF CREDIT, AND INCREASED VOLUME OF CREDIT REPORTING IS NOTICEABLE BUT NOT OVERWHELMING. THE ESTIMATED COSTS RANGE FROM BETWEEN \$3,300 TO \$42,000 ANNUALLY DEPENDING ON THE SIZE OF THE BANK.

ULTIMATELY, THE WISDOM OF A REGULATION DEPENDS ON ITS BENEFITS AND COSTS TO SOCIETY. THE BENEFITS MAY GO BEYOND ECONOMICS, SUCH AS ENDING UNFAIR DISCRIMINATION, BUT SOMEBODY STILL HAS TO PAY. BANKERS WOULD DO WELL TO KEEP TABS ON THE COSTS OF REGULATIONS AND MAKE THEM PUBLIC. IT COULD, I BELIEVE, LEAD US IN THE DIRECTION OF A MORE RATIONAL AND LESS EMOTIONAL APPROACH TO REGULATION.

4) VOLUNTARY COMPLIANCE. THE FOURTH LESSON IS THAT REGULATORS SHOULD STEP UP THEIR EMPHASIS ON SEEKING VOLUNTARY COMPLIANCE. IT'S MUCH MORE EFFICIENT TO GET BANKS BEHIND NEW REGULATIONS VOLUNTARILY THAN TO WAIT FOR INFRACTIONS AND THEN TAKE DISCIPLINARY ACTION. AT THE PHILADELPHIA FED, VOLUNTARY COMPLIANCE HAS BEEN THE CORNERSTONE

OF OUR APPROACH TO ENFORCING REGULATIONS, ESPECIALLY IN THE CONSUMER RIGHTS AREA. BUT VOLUNTARY COMPLIANCE WOULD BE IMPROVED IF WE HAD MORE INPUT FROM BANKS OF ALL SIZES IN THE WRITING OF REGULATIONS. VOLUNTARY COMPLIANCE WOULD BE ENHANCED IF WE ALLOWED MORE TIME FROM THE FINALIZATION OF A NEW REGULATION TO ITS EFFECTIVE DATE SO THAT BANKS CAN MAKE NECESSARY CHANGES IN POLICIES, PROCEDURES AND TRAINING.

ON THE PLUS SIDE WE HAVE IMPROVED VOLUNTARY COMPLIANCE IN A MAJOR WAY IN RECENT YEARS BY INCREASED ASSISTANCE TO BANKS. FOR EXAMPLE, WE HAVE HELPED TRAIN YOUR PERSONNEL, HELPED EDUCATE YOUR MANAGEMENT ABOUT UNDERSTANDING NEW REGULATIONS, HELPED YOU IDENTIFY POTENTIAL PROBLEMS, ACTED AS A SOURCE OF INFORMATION FOR EVALUATING ALTERNATIVE WAYS OF DEALING WITH SPECIFIC REGULATORY REQUIREMENTS, AND SO ON. WE BELIEVE A KEY POINT OF FOSTERING VOLUNTARY COMPLIANCE IS TO SHARE OUR KNOWLEDGE AND EXPERTISE DIRECTLY WITH BANKS IN OUR DISTRICT. IF WE CAN WORK EVEN MORE CLOSELY WITH YOU IN THE FUTURE, I BELIEVE WE CAN MAKE THE REGULATORY PROCESS LESS COSTLY FOR EVERYONE, INCLUDING THE PUBLIC.

5) EVALUATIVE PROCEDURES. THE FINAL LESSON IS THAT BANKERS AND REGULATORS SHOULD NOT ASSUME REGULATIONS ARE SET IN CONCRETE. REGULATIONS MAY TURN OUT TO BE INEFFECTIVE, MAY HAVE PERVERSE RESULTS, OR MAY BECOME OBSOLETE WITH CHANGES IN OUR ECONOMY. WE NEED TO CONCENTRATE ON DEVELOPING AN ONGOING MECHANISM FOR EVALUATING THE EFFECTIVENESS OF REGULATIONS. IN TRUTH-IN-LENDING, THE FEDERAL RESERVE HAS PERIODICALLY EVALUATED THE LAW AND REGULATIONS SURROUNDING IT IN LIGHT OF SUBSEQUENT DEVELOPMENTS. AS A RESULT, A NUMBER OF

UP-DATING CHANGES HAVE BEEN MADE. I HOPE THIS EVALUATIVE PROCESS WILL CONTINUE AND BE EXPANDED TO OTHER REGULATIONS. FAILURE TO DO SO WILL PRODUCE DISTRUST AND WIDESPREAD DISREGARD FOR REGULATIONS GENERALLY.

CONCLUSION

LET ME SUM UP. CONSUMER "RIGHTS" ARE HERE TO STAY AND REGULATION OF BANKS TO SECURE THOSE RIGHTS IS HERE TO STAY AS WELL. TRYING TO STONEWALL THIS MOVEMENT SIMPLY WON'T PAY. MORE REGULATIONS ARE ON THE WAY FOR AGE, RELIGION, "REDLINING" AND THE LIKE.

THEREFORE, A POSITIVE APPROACH AIMED AT IMPROVING THE REGULATORY PROCESS IS MORE APPROPRIATE AND WILL MAKE BANKERS MORE INFLUENTIAL AND CREDIBLE. THIS IS A CHALLENGE TO YOU AS BANKERS AND US AS REGULATORS. IT MEANS YOU AS AN INDUSTRY NEED TO BE MORE ALERT TO SOCIAL AND ECONOMIC CHANGE. IT MEANS YOU--BIG AND SMALL BANKS ALIKE--HAVE TO BE MORE POSITIVELY INVOLVED IN THE REGULATION-MAKING PROCESS. IT MEANS WE ALL HAVE TO BE MORE AWARE OF THE BENEFITS AND COSTS OF REGULATIONS. IT MEANS REGULATORS NEED TO WORK HARDER AT VOLUNTARY COMPLIANCE. AND ALL OF US NEED TO MAKE CERTAIN REGULATIONS ARE DOING WHAT THEY'RE SUPPOSED TO DO--BENEFIT THE PUBLIC.