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CHANGING TIMES IN BANKING

Remarks of

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To begin our dialogue from my supervisory standpoint, let me review some of the major developments now affecting the banking industry, partly through Congressional and regulatory decisions, and partly through underlying technological and economic trends. You are certainly just as familiar as I am with all these developments. But since changes are coming today so fast and furiously, and since they are interrelated in so many ways, it would be useful for us to red-flag some of the major developments--to show how, as a group, they generate changing times in banking. Let's consider in turn the challenges arising from the technological, institutional and regulatory sectors.

Challenges--Computers and Consumers

The subject of technological innovation has been discussed at great length at many banking conferences, including this one, but let me add one brief word more. One of the most significant impacts of technology may be in the area of bank branching. Banks in many cases have increased the size and penetration of their market areas by branching, but at the cost of higher operating expenses and diluted profits. We now realize, however, that branching is not the only possible method of supplying convenient banking services and of improving a bank's effectiveness. Bank managers now have an alternative way of reaching customers through flexible and relatively inexpensive electronic devices. This question may be moot at present, in view of the Federal court ruling that electronic terminals are equivalent to branches, and thus subject to the 48-year-old McFadden Act limiting bank branching. We may have to await a Supreme Court decision on this matter, or perhaps some Congressional decision--remember, Sen. McIntyre

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has suggested that Congress take a good hard look at the McFadden Act. Meanwhile, the technology remains available to support far-reaching institutional changes in coming decades.

Against this background, consider the impact of bank customers--especially through the consumer movement--on the reshaping of the nation's financial system. Sophisticated consumers are now able to obtain high returns from various market instruments and also from money-market funds. Aggressive consumerists meanwhile continue to press for the termination of bank-deposit interest ceilings, which range from zero on demand deposits to 7½ percent on longer-term time certificates. The response is evident in the recent actions of the Senate Banking Committee, which essentially would permit payment of interest on demand deposits at the end of next year and phase out Reg Q ceilings on time-and-savings deposits in 5½ years.

Meanwhile, an increasing number of banks are de-emphasizing the corporate end of the market, in view of all the pitfalls of liability management, and instead are cultivating a larger consumer deposit and loan base. The consumer market is comparatively stable, statistically predictable, comparatively insensitive to interest-rate changes, and potentially profitable with the help of modern electronic processing. The question then becomes, how will the consumer respond to the importunings of the now-ardent banks?

Challenges from Nonbank Institutions

The answer depends on the interaction between the rising competitive challenge from thrift institutions and the far-ranging changes in regulatory ground rules. The institutional changes now underway are rapidly blurring the distinction between demand accounts and time-and-savings accounts--primarily of course through the development of NOW accounts. The public

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increasingly holds its transaction balances and precautionary balances in time-and-savings accounts, with commercial banks and thrift institutions competing directly for such balances.

In this situation, we might expect the regulatory authorities to attempt to enforce roughly similar ground rules for these competing institutions, in line with a basic Hunt Commission principle. Thus, we have several Federal Reserve actions which would help bring banks into line with thrift-institution practices--the authorization for commercial banks to offer passbook-savings accounts to corporate customers, and the authorization for banks to offer a bill-paying service to savings-accounts customers. Moreover, we have the Senate Banking Committee's set of proposals, which would further blur the distinction between the different types of institutions, such as by allowing the expansion of all thrift institutions into the consumer-loan and NOW-account fields.

But the challenge arises not just from the thrifts but from other competitors as well; for example, data-processing and communications firms, credit-card companies, and national and regional retailers. These newer enterprises see the change-over in payments technology as an opportunity to enter the payments business without the operating handicap of having to use paper checks processed through commercial-bank channels. Indeed, as George Mitchell has argued, while the banks and thrifts zealously try to limit each other's competitive effectiveness by statutory or regulatory action, they overlook the very strong challenge being launched by unregulated enterprises.

But remember that banks as well as nonbanks can benefit from shifting market boundaries. In recent years, we have seen the expanding power of bank holding companies in a number of non-bank areas, and we're likely to

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hear a great deal also about the growing strength of the banks in the securities industry. Yet here again, there are changing groundrules. Thus we have the new guidelines proposed not only by the bank regulatory authorities but also by the SEC in its role as protector of investors in bank holding companies. These guidelines represent a difficult compromise between investors' rights and bank customers' rights. In developing them, we have had to weigh carefully the type and form of disclosure imposed on banks, so that we don't undermine the banks' willingness to assume risk--and also don't erode the confidence of depositors, which after all is a key determinant of the banks' ability to attract the funds needed to finance future lending activities.

Uniform Reserve Requirements

One of the best examples of the drive for common groundrules is the Federal Reserve's continuing attempt to achieve uniform reserve requirements. As you know, the Board again this year has asked Congress for authority to extend reserve requirements to nonmember institutions, but with several new features. In contrast to last year's bill, the new proposal would extend reserve requirements on time-and-savings deposits to nonmember depositary institutions, instead of confining them to demand deposits and NOW accounts. In addition, the proposed reserve-requirement ranges would be adjusted downwards, and the proposed exemption of the first $2 million of deposits would be deleted.

The broadened proposal for extension of the coverage of reserve requirements reflects the Fed's strong emphasis on the need for equity among competing institutions; thus, all institutions offering similar deposit services should be subject to similar requirements, especially now that the deposit

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functions served by the various institutions are becoming more nearly alike. The proposal for lower reserve-requirement ranges recognizes the need to maintain the active participation of deposit institutions in credit markets to promote economic growth, and also to assure the flow of credit to key economic sectors such as housing. The withdrawal of the proposed exemption for small nonmember institutions reflects an attempt not to discriminate against small member banks, especially since an exemption of this type could encourage such banks to withdraw from the System.

While recognizing the validity of some of the opposing arguments, I submit that two overriding factors support these proposals. First, they would enhance the effectiveness of monetary policy by tightening the relationship between bank reserves and the nation's deposits. Second, they would promote equity in competition among similar institutions, in a world where the distinction between demand accounts and time-and-savings accounts is being rapidly blurred. Remember the basic principle involved--equivalent cash reserves should be held against similar deposits that serve as a part of the public's money balances, no matter where those funds are deposited. That principle has been upheld by the Fed for years in regard to the thrift institutions' assumption of third-party payments powers, and I'm sure it is universally valid.

Concluding Remarks

What conclusions can we draw from this brief review? Above all, bankers should remember that we live in changing times, affected not only by shifts in regulations but also by shifts in the general banking environment. Technological change is a constantly disturbing element, posing a major challenge to such established practices as bank branching. The demands of a more af-

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fluent and more sophisticated consumer are another disturbing force. Thrift institutions and (increasingly) nonfinancial institutions, by their rapid adaptation to this new environment, provide a serious challenge in many aspects of the banking business. But banks themselves have the potential to expand in new areas by proper adaptation to institutional and technological change. The proper regulatory response in all cases, I believe, would both support an effective economic policy and provide equitable treatment for all concerned--as in the case of uniform reserve requirements.

To help cope with changing times in banking, we might consider several principles first suggested several years ago to the Hunt Commission by a Special ABA Committee which I chaired. Basically, our committee argued that 1) maximum reliance should be placed upon free-market forces to assure an innovative financial system; 2) regulatory processes should be reviewed continually to ensure that all regulations are justified and administratively workable; 3) public-policy measures for financing the nation's social priorities should provide incentives to all lenders and not just certain specialized institutions; and 4) the ground rules for competition among financial institutions should be equitable, with no substantial limitations on the ability of these institutions to compete with one another.

I submit that these principles have held up well, and that they provide a basis for developing an industry-wide position on the issues first chrystallized by the Hunt Commission. But it seems essential that bankers close their ranks and work to forge a unified position on these crucial issues. If they don't, they will only lose their markets, in a piecemeal fashion, to other institutions.

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