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The 1990s:
A Crucial Decade for Financial Services

I. Introduction

A. The kind of rapid change and growth that Nevada has experienced in recent years has created opportunities and posed real challenges for the state's banking industry.

B. But there are also other competitive challenges that banks in Nevada are facing right along with the rest of the nation's banking industry. It is these more "global" challenges that I want to discuss briefly today.

C. Specifically, I want to argue that increased competition, particularly on the international front, is going to set the tone for the entire banking industry in the 1990s.

1. Even if your institution has no international business, international developments are going to affect you in important ways in the '90s.

D. In light of these developments, I also want to suggest an agenda for financial reform in the U.S.

II. Turning first to the broad trends that will shape the banking industry in the 1990s,

A. I think it's clear that heightened competitive pressures are going to be the most significant force for change.

B. Of course, that's nothing new. But the nature of the competition changed during the 1980s, and this has set the stage for what will happen in the '90s.

C. Let me suggest some of the ways competition has changed.

1. First, the competitors you're facing now aren't just Nevada bankers anymore.

a. Because of interstate banking, three of the four largest banks in Nevada are owned by out-of-state competitors.

b. And there's out-of-state competition in Nevada's loan and deposit markets via toll-free telephone lines.

2. Moreover, your competition isn't always *bankers* anymore, either.

a. You're also facing nondepository competitors like Merrill Lynch and Pru-Bache, which have been offering highly competitive services for some time now.

D. The main reason for these trends is technological.

1. I am referring to the computer revolution.

a. I'll give just a few examples of the way it's changed banking:

(1) Cash management accounts. We wouldn't have these kinds of products today without cheap and powerful computer resources.

(2) Two other examples would be shared ATM networks and securitization of loan products.

b. I'm sure you could add other specific examples. But the picture's clear: improved information technology has made it easier and more profitable for financial service firms to compete on one another's turf.

E. Given the technology revolution, I expect competition to intensify in the 1990s.

1. And because financial markets are becoming more global in scope, developments on the international front will be the biggest forces for change.

2. I'll mention two that I think will be key.

F. First, the influence of foreign competitors, particularly Japanese banks, will continue to grow.

1. As recent experience indicates, Japanese banks have ready access to capital markets that will enable them to build market share.

2. In the U.S., Japanese banks are competing effectively for the business of top corporations, and are becoming formidable competitors in retail deposit markets and in consumer lending.

G. A second, and, I believe, more important development that will shape the financial services industry in the '90s is ... Europe 1992.

1. Now, you might be wondering what developments across the Atlantic could possibly mean for financial services in the U.S. and specifically in Nevada.

a. In a word, the answer is plenty.

2. As you know, 1992 is the deadline for the creation of a unified internal market in Europe.

   a. This will involve removing geographic barriers to the flow of goods and services within the European Community.

   b. So, 1992 will give European banks a "domestic" market of close to 350 million people.

   c. Talk about opportunities! Opening this market will mean:

      (1) new and more competitive products;

      (2) more cost-effective service delivery systems; and

      (3) better geographic diversification of risks.

   d. Quite a picture. But what about the U.S.?

      (1) Well, under current laws, in 1992, U.S. institutions will be limited to patchwork of individual states.

      (2) And even if all states were to allow nationwide entry, we'd *still* have a less-efficient delivery system than in Europe.

         (a) Because interstate branching is prohibited under most circumstances.

3. A second way 1992 will affect us is that European financial markets will become more attractive to U.S. firms and investors.

   a. Universal banks will have a lot to do with this.

   b. By "universal bank," I mean a bank that combines lending and deposit-taking with investment banking, stock brokerage, insurance, and mortgage banking, among other things.

   c. This is the model in Germany, and could become the standard for all of Europe because it offers so many advantages to investors and borrowers alike.

   d. Since current laws in the U.S. forbid universal banking, it's likely that U.S. financial markets will lose business.

(1) Already, U.S. corporations pick and choose the markets in which they raise and invest funds.

(2) And it's only a matter of time before households enjoy some of the same opportunities.

H. Now, I don't want to imply that only the big, universal banks will survive in the 1990s.

1. Even in Germany, a substantial number of small, locally-oriented banks and thrifts are thriving.

2. But the point is, smaller institutions can't afford to be complacent.

a. The trend towards universal banking means that the regulatory distinctions among specialized financial service firms won't offer protection against competition.

b. At the same time, profitable market niches are going to get harder to find if we fail to meet the universal banking challenge in this country and allow increasing portions of our financing business to shift to the European market.

III. These observations about international competition in the 1990s lead naturally to a discussion of financial reform in the U.S.

A. There may have been a time in the not-so-distant past when purely domestic considerations could dictate financial policy.

B. But all that has changed.

1. Revolution in information technology has made most geographic and product distinctions among institutions obsolete.

2. In 1990s, then, competition both from the Japanese and the Europeans increasingly will dictate pace and direction of change in U.S. financial markets.

C. So, it's time to begin thinking more globally about the best way to restructure our financial system. Here are some issues we need to look at:

1. Interstate branching.

a. Forcing institutions to enter most out-of-state markets via another, separate institution just isn't efficient.

b. Of course, nationwide branching would increase competitive pressures, and this represents a challenge, particularly for smaller institutions.

2. Regulatory reform.

a. Our current regulatory system, with its multiple and overlapping agencies, is cumbersome and inefficient.

b. We need to ask ourselves whether it makes sense at the federal level to have three separate bank regulators.

c. Moreover, because distinctions between S&Ls and banks are fast becoming obsolete, we need to rethink the need for a separate S&L industry and the OTS, as well.

3. Dual chartering.

a. The decisions we make regarding interstate branching and federal regulatory reform also will have implications for what happens to our dual chartering system.

4. Powers restrictions.

a. U.S. institutions increasingly are competing head-to-head with one another. And together, they're facing increasing competition from banking organizations in Europe and Japan. So, can we afford to preserve product-related barriers in the provision of financial services?

b. It's probably even worth examining whether the separation of banking and commerce needs to be so airtight as it is currently.

5. Finally, deposit insurance reform.

a. I see this as a very desirable precondition of other financial reforms.

(1) Congress isn't likely to give institutions expanded powers without also ensuring that adequate safeguards are in place.

b. To me, the keys to meaningful deposit insurance reform are:

(1) More stringent capital requirements, particularly for those institutions that are

considered highly risky.

(2) Progressive discipline for those institutions failing to meet their capital requirement.

(3) And finally, prompt closure or reorganization of fatally weak institutions.

c. This means that forbearance must go; no institution should be considered too big to fail.

d. At the same time, it also means that we can reform deposit insurance without having to reduce the $100,000 deposit insurance ceiling.

IV. I've laid out a full agenda for the 1990s.

A. But if we fail to confront the issues head-on, we'll end up losing more than just a battle.

B. Whether we like it or not, international competition, particularly from the Europeans and the Japanese, increasingly will challenge U.S. financial markets.

C. If we want to preserve a healthy and vibrant financial services industry in this country, we need to rise to the challenge.