FUTURE CHOICES FOR BANKERS

Address by
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Before the
92nd Annual Convention
Missouri Bankers Association
Stouffer's Riverfront Towers
St. Louis, Missouri
May 14, 1982

I am both pleased and honored to have been invited to address this, the 92nd Annual Meeting of the Missouri Bankers Association. As a former commercial banker and a past member of this association, I am well aware that these annual conventions serve two important purposes: they serve as forums for discussion of the vital current issues facing bankers as well as offering an opportunity for many of you to run up the entertainment overhead of your correspondents.

I must confess that, in choosing my subject, I was sorely tempted to use this platform to promote the wide range of superb services that the Federal Reserve Bank of St. Louis can offer you. Now that we're charging for our services, we can ill-afford to overlook any opportunity we might have to advertise our low prices and incomparable products. But, my better judgment prevailed and, instead, I will address a subject that, in my opinion, encompasses the most important issue facing banking today. It is a subject that has produced major divisions among bankers and has provoked serious antagonism between the banking industry and a wide variety of non-bank financial institutions. As you might have guessed by now, I want to talk to you about banking deregulation.

Now, let me say up-front that I am fully aware that banking deregulation may not be the favorite subject of all of you; indeed, some of you might consider it downright distasteful. This was brought home to me, somewhat forcefully, several years ago when I spoke to the Kentucky Bankers Association and made what I considered to be a rather moderate proposal, namely, that Regulation Q be eliminated. Judging from the reaction I received, I feel fortunate not to have been tarred and feathered and run out of town on a rail. I learned from that experience that some bankers view the prospect of deregulation in the same way that the Book of Revelation describes Armageddon -- a catastrophe that could destroy their universe.

In my opinion, this sort of reaction toward the prospect of banking deregulation is not only mistaken, it leads to a state of mind that could ultimately spell the downfall of the commercial banking industry. For, banking deregulation does not represent the end of the banking world as we know it; it represents, instead, a necessary and challenging beginning. Indeed, it offers the best, perhaps the only, long run prospect for profitability and growth. Let me tell you why I believe this to be so.

Both you and I share a common Missouri tradition -- we like to view things as they really are, even if the view is not what we'd like it to be. In looking at recent trends in banking, both nationally and here in Missouri, it is clear that your industry has suffered serious erosion in recent years. This is dramatically reflected in a few simple statistics:

First, banking's share of the lending market has been significantly reduced. Ten years ago, banks provided nearly one half of all loans made by financial institutions; today, banking's share is only one-third. Ten years ago, banks provided more than 40 percent of all loans made to non-financial borrowers; today, they provide only 25 percent.

Second, the public is becoming less interested in holding deposits at banks. In 1945, U.S. households held 35 percent of their financial assets as deposits at commercial banks; today, they hold only slightly more than 20 percent there. In the past ten years, the liabilities of non-bank financial institutions have grown at a rate double that of banks. Last year, liabilities of money market funds alone increased by more than did the net liabilities of all commercial banks.

Third, the rate of erosion of banks' aggregate share of the market is increasing. Perhaps the most striking example of this is the steady decline in the rate of growth of U.S. commercial banks' total deposits. Total bank deposits grew about 11 percent per year from 1970 to 1975; growth then slowed to less than 10 percent per year from 1975 to 1980. Last year, total deposits grew only slightly more than 6 percent and, if adjusted for inflation, actually declined.

Here at home in Missouri the relative trend has been equally disturbing. Over the past ten years, the total assets of Missouri banks have risen slightly more than 9 percent per year -- somewhat below national trends. Over the same period, Missouri savings and loan associations experienced asset growth of nearly 14 percent per year, while Missouri credit union assets have grown by 16 percent per year since 1976.

The bottom line is simply that the banking industry has been slipping behind -- further and further behind -- other financial institutions.

What is responsible for this decline? It is due to the unintended, but nevertheless damaging, consequences of a host of regulations that, through the years, have been thrust on banks, sometimes at their own urging, sometimes at the urging of competitors. Banking must surely be the most thoroughly regulated industry in this nation. The National Banking Act of 1863 was the first of a long series of banking regulations. More familiar are regulatory products of this century: The Federal Reserve Act, the McFadden Act, Glass-Steagall, the Bank Holding Company Act, and on and on. Since the mid-sixties, Congress has saddled banking with at least one major new regulatory law each session. Just to remind you, these include: the Housing and Urban Development Act, Truth-in-Lending Act, Bank Protection Act, Currency and Foreign Transactions Reporting Act, Fair Credit Reporting Act, Interest Rate Control Act, Fair Credit Billing Act, Equal Credit Opportunity Act, Real Estate Settlement Procedures Act, Home Mortgage Disclosure Act, Consumer Leasing Act, Fair Debt Collection Practices Act, Community Reinvestment Act, International Banking Act, Financial Institutions Regulatory and Interest Rate Control Act, and, most recently, the Depository Institutions Deregulation Act and the Monetary Control Act of 1980.

I think that it is accurate to say that banking is the only industry in which regulations determine who can enter the business, where they can locate, what services they can offer, and what prices they can charge. Some of the most recent banking regulations even attempt to determine to whom you should lend and what signs you should hang in your bank lobby.

As is usually the case, most of these regulations were enacted with the best of intentions. They were intended to build walls: walls to protect banks from other banks, walls to protect bank customers from bank failures, walls to protect society from "credit crunches"; and walls to limit competition between various financial institutions. And, indeed, these regulations did, at first, build protective walls around banks and banking markets.

Today, however, the protection these walls formerly provided is gone, but not because banks have been successful in breaking out. Instead, other institutions have successfully broken in -- into your markets, into your services, and into your profits. Non-bank financial institutions -- your competitors -- most of whom are not subject to the extensive regulations affecting banks, are offering bank customers a wide variety of services that previously only banks could offer. They are also offering services that banks are prevented, by law, from offering. Sears, Merrill Lynch, American Express, and, believe it or not, even the Parker Pen Company, are now in the banking business -- and they are free to provide services that you, by regulation, cannot offer, in places that you, by regulation, cannot go, at prices that you, by regulation, cannot pay or charge.

The problem facing bankers is simply that, despite what you may have read or heard or believe, whether you wish it or not, deregulation of financial markets is <u>not</u> the wave of the <u>future</u> -- it is the wave of the <u>present</u>. Deregulation by <u>innovation</u> is here now -- for almost every financial market institution except banks. And don't be misled; every new financial instrument, every new financial service is an innovation designed to circumvent some existing regulation. Innovation <u>is</u> deregulation. Such innovations have transformed regulations that once were viewed as suits of armor for bankers into straitjackets that now prevent them from responding to the challenges of new competition and new markets.

What choices do bankers have? Some bankers seem to believe that salvation can be found by choosing what I would call a "Maginot Line" strategy. They seem willing to tolerate their current regulatory burden in the hope that they can extend those regulations to other financial institutions. These bankers lean toward re-regulation in the belief that this would place all financial institutions on an equal footing. I don't believe that this is a viable option, for I am convinced that attempts at re-regulation will fail just as surely as the Maginot Line failed. The "blitzkrieg" of financial innovations and marketing ingenuity have already made the Maginot strategy obsolete. New regulations simply will not keep pace with financial innovations. Even if re-regulation were to become the accepted doctrine, it would take time to recognize a new innovation, time to reach a consensus of how to regulate it out of existence, and time to impose the regulation. In that time, those who remain regulated will always lose out to new competitors and to new methods of financial competition. And then some new innovation will pop up again.

Other bankers who have more confidence in themselves and, perhaps, a better sense of history, have confronted the problems facing the banking industry by calling for deregulation of all financial institutions. In my opinion, this is the only way that banks can be assured of being able to compete effectively. I believe this is the only strategy that will succeed. Only by permanently removing the regulatory walls that are now walling bankers out of the financial arenas can the banking industry remain a sizable and significant part of this nation's financial system.

There is, of course, a third possibility -- that the banking industry will end up doing nothing about deregulation. Like the proverbial donkey that starved to death because it couldn't decide which bale of hay to eat, it is possible that bankers, if unable to reach a consensus on re-regulation or deregulation, might simply opt for piecemeal changes in current laws. In fact, this possibility is the one that some expect will actually occur. One recent study of financial markets specifically predicts that banking will continue to lose its market share, principally because bankers will be unable to agree among themselves about deregulation. The study concludes that the most probable prospect is that regulation will be only partially eased over time and this will occur only after the industry's plight reaches crisis proportions. This is the "let's hope it'll all go away" syndrome.

These then are the three choices you have. You can continue to argue among yourselves, community bank vs. city bank, small bank vs. large bank, in-state bank vs. out-of-state bank -- and accomplish nothing. While the battle goes on over which bank owns the henhouse, the chickens and the eggs will probably have been stolen by your unregulated competitors. Or you can try to live with existing regulations and attempt to devise new ones to wall in your competitors. However, I predict that you will find that these new walls will extend <u>into</u> your markets and will merely encourage new innovations and new innovators. Or, you can push for deregulation of all financial institutions, which will enable you to compete head-on with your adversaries on a truly level playing field.

You may not like these choices, but they are the only ones you have. In my judgment, you don't have the option of avoiding deregulation. By and large, your choice is simply whether you will be the master of your fate by helping to guide the direction deregulation will take, or whether you will follow from the rear and let others dictate the direction and the distance. In other words, you can march up front with the generals or in the rear with the rank and file. Just remember that, at the end of the war, the generals usually get the medals while the rank and file are "mustered out."

One last comment. You may have the best strategy in the world, but if your timing is wrong, you'll still lose out. Time is running out for the banking industry. Everyday, in the American Banker, the Wall Street Journal, and other financial journals, there are reports of new competition in financial markets, new options, new firms, new alternatives for the public to turn to for financial services. If you are still not convinced that a serious problem exists, just think about this. Last year, the amount that individuals in the U.S. saved out of their incomes was $107.3 billion; last year, money market mutual funds increased by $107.5 billion.

I realize that I have painted a pretty grim scenario. I have done so purposely, because I do not think that anything is ever accomplished by wishful thinking.

On the other hand, the history of commercial banking in the United States is impressive. Banks and bankers have been in the forefront of what is still the strongest economic system in the world. This impressive record could not have been achieved without foresight, the capacity to make decisions realistically and an ability to adapt to new conditions when they occur.

Nothing in this world is static. Circumstances constantly change. In one generation we have seen the transition from the horseless carriage to the automobile; we have witnessed the emergence of nuclear fission; we have observed repeated evidence of man's ability to survive and progress in spite of changing circumstances.

I have full confidence that commercial bankers have little to fear from the competition that lies ahead. You possess the resources, the marketing ability and the competitive capacity to prevail if you will only assess the situation with the same realism that characterizes the conduct of your daily business. Knowing you as I do, I have little doubt that you will respond to the challenge and continue to contribute mightily to the future growth and prosperity of this great nation.