

Thank you very much Bud. I thought when you were talking about ducks you were talking about Russell Long's recent comment about, "If you want to hit ducks, if you want to shoot at them, you should aim ahead of them, because if you aim at them you'll never get them. And then I thought probably you did mean to refer to ducks because I'm the target today and I hope you'll aim at me and miss me instead of aiming ahead of me and getting me. But I'm sure that my appearance here is somewhat unnecessary because I understand you've already decided on the issue. But then I remembered the International Banking Act and so I hope it's obvious that the banking community and the ABA is able to correct their mistakes in a hurry and so I'm sure you still have that capacity in this case.

I want to start off by agreeing with you. I agree with you that the issue we're talking about is not membership in the Federal Reserve. It's a much broader and more fundamental issue of equity and fairness and I see you've gotten up here the four criteria and I was going to refer to three criteria because that is what was in your testimony before the Senate House Committee and I'll refer to the three because I can't remember the four. But the fundamental objectives you laid down in the testimony of your president-elect was to assure the continued independence and effectiveness of our central bank in its management of monetary policy. Second, to enhance the efficiency of the payments system and three, to eliminate arbitrary forms of discrimination against particular types of financial institutions which inhibit the delivery of banking services at least possible cost.

I'd like to suggest that we test all of our proposals against those kind of criteria and see if they meet the standards that we all desire.

When I came to Washington I was aware of the membership loss in the Federal Reserve because of my experience as a Director of the Federal Reserve Bank of Boston where there had been the greatest loss over time. The issue as we saw it in Boston was not the question of loss of membership, the question was why we were losing members and there was no question in our minds that we were losing members because membership put banks at a competitive disadvantage. They were burdened by membership and were not able to compete fairly and earn the same results as those who were not members. So it became clear even then that the issue was fairness and equity, fair competition and I since that time have tried the best I could to begin to formulate the responses to that kind of problem. It seemed to me that we have a really peculiar structure in financial institutions in this country that have a well known historical base so they're understandable but they are not necessarily what we need for the 1980's, 1990's or the 21st century.

We have the question of members versus nonmember banks. Members are burdened in a way that nonmembers are not. And we have the question of banks compared with nonbanks, near banks, other financial institutions that are more and more performing the functions of banks. So it seems to me our objective ought to be to eliminate or to minimize to the extent possible the unequal treatment among

financial institutions and create the best environment for equal handicapping and equal opportunities to compete for the market.

The approaches to doing that perhaps could be many, but there are two that we have been addressing recently. One represents a long-term Federal Reserve position. That is that a solution of providing equity and equal handicapping would be to have universal reserves. This is not a new Federal Reserve position. It predates my time by many, many years going back into the last decade. If we cannot achieve that because of whatever reasons there may be, political or industry or otherwise, then an alternative is to least reduce the burden of membership so that we make more equal the opportunity for members to compete with nonmembers and there you are well acquainted with my earlier enumeration of the elements that I thought were essential to reducing that burden. Those elements consisted of looking at some adjustment of reserves within present statutory limits to make reserve reduction part of the reduction of burden, second, to find a method of compensating for reserves in some form, and third, to unbundle the services of the Federal Reserve, to charge for them in order to restore an opportunity for the private sector to perform and to build in the future more capacity to handle those services and to diminish over time the Federal Reserve presence in the service business. And fourth, to reimburse the Treasury for the loss of revenues it might suffer since otherwise we would not likely find the support in the Administration or in the Congress.

My timetable on trying to tackle this problem was very simple. In view of the trends and in view of the inputs I have received from many of you and other bankers of considerable size of their concern about the burden of membership, when I first took office I indicated that I would present by mid-year, after study by our staff, some proposals that could lay before us some options. This would be an opportunity for comments, suggestions and also proposals, but I hoped and felt that the time was right to move ahead and either resolve the issue or not resolve it. If we resolve it and create the kind of fairness that we need we will greatly enhance the role of banks in the future delivery of financial services, if we fail to solve it the window may not open again and we'll go on as we are, the world will keep going and banks will have a smaller role and that could be a conscious decision. I have no philosophical base other than I'm supposed to be working for banks in this regard to try to help solve this. I've been working for you in this effort.

The result of these studies for mid-year was to come up with two two-prong proposals. It was essential that we present two choices. The Committees of Congress were particularly strong in feeling that they should have those choices because many of them had reservations about the approaches that we took limited to reducing burden of membership. And so our two-prong approach has been one, to provide a program of universal reserves which would put everyone on the same basis and therefore eliminate the question

of burden, if everyone is treated the same there can be no burden. The other proposal, of course, was the one for payment of interest on reserves charging for services worked out carefully to operate within the constraints of money that we thought would be possible and would gain the support of the Treasury and the Office of Management and Budget.

Now what has happened. We've had hearings, we've had inputs, we've had comments--from which have come a number of suggestions and you've been discussing a number of options. One of the options that has come forward is the Reuss initiative in which he has combined a program of universal reserves with lower levels of reserves, narrower ranges for reserves, and other aspects that I'll discuss in a moment which you are familiar with. We have responded to that particular proposal in answer to his request and have indicated the areas where the Board of Governors feel that the proposals are inadequate and where alternate changes would be necessary to gain our support and we have worked diligently to try to narrow the areas of difference in order to have at least the program that could be looked at as comprehensive, finally worked out that everybody could address themselves to. It's very hard to address selves to moving targets. We need a target that's been worked out as best as we can and that we can examine, try to improve, try to make work. We've also had Senate Committee response and we've had industry response, so we're now in a position of having just about as much light as we can get on the subject, which is not a new one, anyway.

With this background let me go back for a moment and review with you what I think might be the basis for your consideration of these proposals. At least if I were in your position I would first like to say, what is the ideal system that meets all your criteria? What is the ideal system that in my wildest dreams I would like? Let me tell you what I think it might be. One, universal reserves for all financial institutions without any exemptions. Uniform reserves as to similar deposit liabilities. Three, market interest rate paid on those reserves. Four, fair pricing for Federal Reserve services giving adequate scope to the development of private services. Five, open access to the Federal Reserve as the central bank for the nation, not for some of the nation, and six, a dual banking system, dual supervision continuing, no need to have the Federal Reserve presence in total and no reason not to have the dual system operate. So those would be ideal. The Federal Reserve and addressing either the ideal or the practical doesn't seek to extend its involvement. It only seeks to assure that we have an equitable system of financial services and an effective monetary policy. Our aim is to come as close as possible to that ideal and yet to be practical enough to get something adopted that we can live with within the existing constraints that will greatly improve the probabilities that banks will have their fair share of the financial market.

The constraints you all know. The constraints of the views of the members. Would these adjustments leave them still carrying the burden or not? The concerns of the nonmembers, are they expected

to pick up something in the handicapping race to give them a more equitable relation to other banks? The concerns of the thrifts and other financial institutions. They'll be drawn in **with the same** rules of the game to play against you. They'd like to play by different rules. Concerns of the U.S. Treasury as to its revenues. Concerns of Congress, the political aspects of all of this, including the money, and the concerns of the Federal Reserve, that we just don't short-sidedly dismantle a monetary system and a payments mechanism that is essential to the vitality of our economic progress.

The Reuss proposal and the Board's comments have, I think, considerable merit for your consideration. I'd like to just review it officially and indicate the areas of continued disagreement and then I would like to try to relate that sort of plan which is certainly not the only solution but may be perhaps among the best that we can achieve at this time. To your own consensus, as I understand it, and to see how your views relate to this particular package. We're dealing now with an updated Reuss proposal. Basically, we're talking about a substantial reduction in the statutory reserve ranges and a substantial reduction in the reserve requirements. The Reuss proposal did contemplate initially a reserve requirement that was the same for every type of reservable liability. We have now developed an alternative that would differentiate between demand deposits, NOW accounts, savings accounts on the one hand and time deposits on the other, it being our view that time deposits should carry different and lower reserve requirements. We have worked with the numbers to

set the reserve requirements within the constraints of revenues, loss of revenues to the Federal Reserve, loss of revenues to the Treasury that we think are acceptable or practical. We do have a series of debates with the House staff on some of these definitions. My judgment is that we would be able to resolve those in a way that I think should be acceptable to the banking industry. We have come to the view that if all other things could be achieved, that a reserve requirement applying equally to demand deposits and savings account would be acceptable. The reason is that as we move into the automatic transfer regime it is going to be increasingly difficult to distinguish between funds that are held for transactions and funds that are held for long-term savings if they are in these kind of accounts and there is a good deal of logic, therefore, of having the same reserve requirement.

It is our view that short-term time deposits should have a lower reserve requirement, should exclude Federal funds and RP's, we have some debate with the staff about that, and should have an adequate range of discretion to the Federal Reserve so that monetary policy can be executed from time to time in terms of the management of liabilities. And it has been our view and, I believe the House accepts this, that there should be a narrower range of reserve requirements on long-term time deposits which initially would be one per cent. So that is a general view of and you have copies of perhaps some versions of this. It's being worked on constantly and we're trying to resolve the issues where we think your interest and our

interest would be better served. As to the exemption which I believe is a controversial matter with you, the House, the Reuss proposal has now been adjusted to contemplate a \$50 million exemption for the demand and similar deposits and a \$50 million exemption for time deposits. It has been our view, the view of the Board of Governors that in order to continue to have adequate coverage and to look at the equity of like institutions being more equally handicapped, that this should be at a \$25 million level. The Reuss proposal contemplates indexing that exemption to the nominal growth of GNP. It has been our view in the Federal Reserve that there should not be indexing. Certainly we would be very concerned about indexing to the nominal GNP. It has been our view that there should be some provision relating to affiliated groups. As a side note it just doesn't seem to me to be right that we can have multibank holding companies, one bank of which is a member of the Federal Reserve and the services of the Federal Reserve are furnished to the whole group through that one member. I don't think that's fair, I don't think it's right and I think that therefore some address should be made to avoiding these exemptions being used by dividing banks into pieces and therefore avoiding any reserve requirements which I think would be unfair. There should be a grandfathering because there is no intention to hurt present structures but certainly wouldn't make sense to allow the good Mellon Bank to split into one-hundred banks and never maintain any reserves. Jim says he would like that.

It is also a difference between ourselves and the House Banking Committee over the question of what universal means. We believe it should mean all banks, all commercial banks, and should also cover all other institutions that have depository transactions accounts. So that as other kinds of institutions be they thrifts of any form, credit unions, S&Ls or any other form of financial institution comes into being and gains a market position, they will know in advance the rules of the game and when they become of significant size, they'll play with the same rules in offering these services the banks play with, thereby assuring that in the future we don't have another case of an omitted coverage that comes out to be discriminatory against banks and we have also the issue of access. The Reuss proposal has contemplated that all institutions who would be required to maintain would be subject to reserve requirements under this proposal would have access to all Federal Reserve services. We think that is a fair proposition. Members could have access whether or not they are subject to reserves and those that are subject to reserves could have access whether or not they are members. The Reuss proposal went one step further and said for all those banks that are not subject to reserves they should at least have access to the discount and we agree with that because we believe the central bank's function is to make sure that we do not have a problem. Situations arise in which liquidity crunches could trigger off unpleasant circumstances. We do not see the need for the Federal Reserve to move into a supervisory role by opening the window. We would look to the FDIC to give

us any inputs we needed on solvency or that sort of thing to make sure that we were not dealing with institutions that should be treated in a different way. Putting all this together and trying to synthesize where we now are, let me tell you that I think there are only three major differences between the Federal Reserve Board's view of this proposal and the House Committee's view, the House Staff Committee, it's not the Committee, the Committee has not voted. This is not the view of the Committee and many members may have a different view. That difference goes one, to whether or not this would cover nonbanks. Our view is yes and incidentally if our proposal were adopted five thrift institutions would be covered by reserves--five. But the point is that if thrifts later get into the banking business they would automatically know the rules of the game are going to be that way. Second difference is the level of exemption. I'm not sure. Maybe we can work this difference out. And the third difference is indexing, and perhaps we can work that out.

With Senator Proxmire we have only a couple of differences. He wants Fed funds and RPs to have reserve requirements the same as demand deposits. We do not think that is right or workable. He wants to limit the amount of impact of this proposal on Federal Reserve earnings and therefore require higher reserve requirements than we do, otherwise I believe he is in concurrence with the Federal Reserve position. So what I'm saying to you is at least the Committee Chairmen and many of their staffs and some of their associates are coming

closer and closer to the kind of a plan that seems to us might be a major step forward providing that equity, that fair treatment that we think everyone needs. Now let me add that

Now let me add that in pricing this proposal out, everyone recognizes that no legislation is needed in order for the Federal Reserve to charge for its services. Therefore, the Committees are going forward with the understanding that we will unbuckle and we will charge for services. And they're looking at the cost of this based upon our estimates of when we finally get service charges in in 1980 what that would contribute in new income and what this reduction of reserves would contribute in reduction of income and the net effect and it's that figure they're focusing on to make sure that they protect what they view to be their responsibility in protecting the Federal Treasury.

I mention services because it seems also to be an item that occasionally has misunderstanding. I know that many people view the idea that the Federal Reserve should charge for services based upon full allocated costs of providing those services. I just have to say to you frankly that I don't think it's in your interest, I think you'd be very poorly served. If you suggested that a system built up in 65 years and gave away its services should tomorrow price itself on a basis that none of you would if you were in business and therefore drive itself out of business and therefore create serious dislocation problems for the Federal Reserve. I don't think the Federal Reserve will do it. I don't think we'll dismantle our plants and lay off the

people and go out of business, and incidentally, against competition it had marginal pricing, you could price anyway you want, nobody mandates how you price. So I don't think it makes sense to mandate the Federal Reserve inasmuch as you don't want anyone to mandate how you price. I do think it makes sense for us to have competitive pricing. Pricing that, in my view, will be designed to maintain the basic level of service. It will be designed to see that more services grow in the private sector because I think there is more innovation, I think there is more choice of optional forms of service, high and better use of services that is done in the private sector. I believe in the private sector but I have a responsibility not to create chaos in the process, but to have a smooth transition that works, not one that is intellectually interesting but is practically unsound.

I also think that there is a misunderstanding about the effect of all this. I know from your discussions many of you seem to think that this plan would impact the correspondent business. Just the contrary. It will greatly enhance the correspondent. You have now member banks who maintain reserves who buy their services from correspondents. Why would those same banks when they don't have to maintain any reserves and would have to pay for them if they went to the Federal Reserve suddenly decide to come to the Federal Reserve and pay for them while they're now paying for them twice. It doesn't make any sense. They're paying for them now and maintaining reserves which they won't be required to do and they're paying for them at your correspondent banks now. So, you know, what am I missing. There must be some

misunderstanding about how some people operate, because when you have eleven, twelve thousand banks of smaller size who will not be required to maintain reserves and who will not have any access to Federal Reserve services, I don't know why that wouldn't be the most happy hunting ground for correspondence business there could be. The only access to services those banks will have is the window. They will not have access to the other services. I don't see why that isn't highly favorable to building a private sector service network, which I favor.

Now having made a general review of the program, let me look at what I assume was the beginning, maybe you have changed it, but what I understood this morning was the concensus of your position about all of this and I'm going to quote from what I believe is a paper but maybe you have changed. The first point I pick up is that the proposition is made that the solution is to reduce Federal Reserve requirements and statutory reserve ranges sharply. Well I assume, therefore, that you are in favor of the Reuss Federal Reserve plan because that's what it does. It reduces Federal Reserve requirements and statutory reserve ranges very sharply and it limits them so they can't even be raised later to the levels in any other regime that would now be possible. I gather however, that there is some sentiment that perhaps the solution is just reducing reserve requirements and nothing else. Well let me point out the two things about that. If we reduce reserve requirements under the present statute to their bare minimum we would reduce

the burden of membership for all members but we would do so inadequately for medium and small sized banks and therefore we would exasperate our problem. Large banks would be much favored by that action, medium and small banks wouldn't, and so I think they'd all leave the System, so I don't know what that gains for anyone in terms of a sound system, and second, if we should seek statutory authority, legislation to reduce reserve requirements, I think it is unrealistic to expect Congress to reduce them to a level which would impact the Treasury greater than the amount of money that they see that they're willing to impact so I think we have a constraint in how much can be reduced is the

All of us have a window to move through. We have precipitated the issue deliberately because we believe that we need it to be precipitated, there needs to be a pressure point, there needs to be a time in which you can act or not act, and I just hope that all of you realize the risk that we run into ^{if we} fail to find a way to harmonize our viewpoints and work together to find the best plan rather than divide up on some other lines, destroy any action and probably put off for a long time the opportunity to reinstate this window. Our view is not to build a Federal Reserve but to build a system that works. Our view is that we welcome any criticism of a particular plan, any improvements over a particular plan, any particular suggestions. We have difficulty with generalized objections because we don't know what the alternative is and if the ABA's position is generalized and its failed to come forward constructively with an alternate worked out and costed so that the Congress can say, "That will cost so much and we'll buy it." If you have such a plan and it's better than ours I'll buy it and that's all we're trying to accomplish. If we can do that I think we'll have done something for the banking industry that you'll look back on and like.

Thank you so much.