

1984 Bank Structure Conference highlights

Since the turn of the decade, the financial services industry has undergone dramatic changes. The pace of nonbank entry into the industry has accelerated; banks and other depository institutions have become more aggressive and innovative in their product offerings and in their attempts to circumvent banking regulation; and legislators and regulators have become more responsive to the new and ever-changing financial climate.

The separation of banking and commerce has begun to disappear. "Nonbank banks," most of which have been organized since 1980, have swelled to more than 60 in number. Over half of these are owned by securities firms. In 1982, banks and S&Ls began to offer discount brokerage services, and more recently, a few have begun to lease space in their lobbies to insurance companies and real estate agents. Further, the market for many financial services is national, and for many suppliers, international. Today, interstate banking is an important topic in many state legislatures. Indeed, at least 19 states already have passed some sort of limited interstate banking legislation. Also, technical developments have allowed nationwide networks of automated teller machines to form, thus giving customers access to their funds anywhere in the country.

This new financial environment and its implications for depository institutions, regulators, the American public, and their elected representatives were discussed at the twentieth annual Conference on Bank Structure and Competition, held in Chicago at the Westin Hotel from April 23rd to the 25th. The conference, sponsored by the Federal Reserve Bank of Chicago, assembles academics, economists, regulators, bankers, and other practitioners in the financial services industry. This year's conference was attended by some 300 participants who discussed the key issues that the financial community now faces, including bank product and market expansion, the viability of small de-

pository institutions, and current economic and regulatory issues.

Product expansion

Bernard Shull, professor of economics at Hunter College, pointed out that banking was separated from commerce some 200 years ago for fear that "the government-bank relationship . . . would lead to government intrusion into private market activities." The functions of banks have changed since then and, as many speakers concluded, so too should the list of banks' permissible activities.

Two presentations attempted to uncover the potential impact of banks' participation in the securities area by looking at the foreign experience. Laurie Goodman of Citibank and Christine Cumming of the Federal Reserve Bank of New York, after examining the financial markets in five countries, concluded that "countries with product line restrictions tend to have better developed financial markets. In countries where banks are able to offer a complete array of financial services, the banks are more likely to perform many of the functions of the marketplace." Anthony Santomero of the Wharton School looked at the financial structures of the countries that belong to the European Economic Community and examined the impact in those countries of banks holding equity securities in their portfolios. Santomero concluded that, on a macro-economic level, "the inclusion of equity in bank portfolios increases financial sector integration and reduces interest rate volatility." He added, however, that these results are usually accompanied by increased price instability in the real sector.

The discussion of banks' expansion into the securities area extended throughout the Conference. While some were debating the pros and cons of allowing banks to engage in securities-related activities, George Kaufman, professor of economics and finance at Loyola University and

consultant to the Federal Reserve Bank of Chicago, argued that banks have already made significant inroads into the securities field and that, regardless of the Glass-Steagall Act, which separates investment and commercial banking, "banks can do almost anything they want to."

While Kaufman did list some securities-related activities that banks are prohibited by law from entering, he also pointed out that ways have been found around these restrictions. That banks have been so slow in circumventing the law is probably because the technology for doing so profitably is of recent vintage and there are more profitable opportunities elsewhere. There have been, however, quite a few aggressive and innovative banks in the securities area recently; among them are Citibank, Security Pacific, Bankers Trust, and Bank of America.

Geographic expansion

At the conference, the views on interstate banking were mixed. Some participants, however, did agree that the restrictions on geographic expansion should be removed, but a consensus on how to remove those restrictions would have been difficult to obtain, as the distinguished panel of speakers at the session on interstate banking illustrated.

The first to speak was Thomas Theobald, vice chairman of Citicorp/Citibank. Theobald, while all in favor of interstate banking, expressed strong doubts that regional interstate banking would be an improvement over the present system: "Instead of fifty protected markets, there would be a smaller number, but they would also be insulated against some of the most potent competitive forces in the industry." As a result, "customers would be prevented from seeking the best deal the market had to offer."

Thomas Storrs, former chairman and chief executive of NCNB Corporation, disagreed with Theobald. Storrs believes that size is a definite benefit in banking and that the drive by bankers to increase size and market share through mergers would lead to a banking oligopoly. According to Storrs, therefore, regional interstate banking is the best "means of producing additional banking companies capable of effective competition

with money center banks and other large financial institutions."

The viability of small institutions

Discussion about expanding banks' product and geographic markets usually leads to concerns about the viability of small institutions. At this year's conference, a full day was devoted to the future of small banks and other financial firms. Among those to speak on this topic were Joel Bleeker of McKinsey Co. and Richard Wurzburg of the Bank Administration Institute (BAI).

After studying other industries that had undergone deregulation, Joel Bleeker found that four types of "winning" firms usually emerge. Included among the "winners" is the community firm, but one clear "loser" in other deregulated industries is the regional firm. According to Bleeker, as soon as the barriers to interstate banking are lifted, regional firms will be threatened by the "large national distribution companies" such as Merrill Lynch and Citicorp.

Richard Wurzburg discussed the results of an in-depth BAI/Arthur Andersen survey of hundreds of CEOs of banks and other financial institutions who were asked about their views on the future of banking. Wurzburg reported that most CEOs believe "community banks will tend to focus on personalized retail services to preserve the geographic niches they enjoy today," while large banks will primarily be wholesale institutions. Large banks, however, will devote "very significant attention" to upscale customers, thus competing directly with mid-size banks.

Both Bleeker and Wurzburg foresee a drastic reduction in the number of banks. In drawing parallels between financial services and the brewing industry, Bleeker projected that by the year 2000, the number of banks will have declined to 7,000, with between five and seven large national survivors. Most CEOs, according to the BAI/Arthur Andersen survey, would corroborate Bleeker's forecast as most see the number of banks falling to 9,600 by 1990, primarily as a result of a major industry consolidation. Furthermore, 50 percent of all banks expect to be involved in a merger or acquisition by the turn of the century.

Regulatory issues

One factor that will play a major role in the future of all financial institutions—large or small, few or many—is the regulatory and legislative environment. As the speakers who commented on the current regulatory issues and the recommendations of the Bush Commission indicated, the future of regulation and of the financial sector is an interactive process. Andrew Carron, vice president at Lehman Brothers Kuhn Loeb, pointed out that structural changes in the financial sector “diminish the advantages and magnify the shortcomings of the current [regulatory] system.” All the speakers seem to have agreed that changes in the financial structure necessitate legislative and regulatory changes, but the speed, nature, and implementation of those changes will have far-reaching implications for the financial services industry.

The Bush Commission, a task force headed by Vice President Bush and having as its members the heads of all the important regulatory agencies that deal with financial institutions, addressed the problems of regulatory structure. Two important recommendations of the Commission are, first, a move toward “functional” regulation and, second, increased state supervisory powers over state-chartered institutions. The first recommendation calls for the FHLBB to supervise those institutions classified as thrifts. A new regulator, the Federal Banking Agency (FBA), would supplant the Office of the Comptroller of the Currency and be responsible for all national banks and their holding companies, except for the 35 largest national bank holding companies. These, along with all state banks and their parent holding companies, would be supervised by the Fed. But according to the second recommendation, state banking agencies, after being certified by the federal agencies (the FBA, the Fed, and the FDIC), would assume the supervision of state-chartered banks.

All of those who spoke on the Bush Commission recommendations agreed that the proposals, if adopted, would be a step in the right direction. Some, however, found a few shortcomings. Leslie P. Anderson, professor of banking and finance at the University of Tennessee,

intensely studied the failure of United American Bank and other “Butcher” banks. He noted that in this case seven different regulatory agencies, which were represented by various regions within each of the agencies, audited 40 different banks in two states, but never in unison. Consequently, the problems at the “Butcher” banks went uncorrected for some time. Anderson hoped that the Bush Commission recommendations would ensure that such a situation would not be repeated; however, he also expressed concern that the recommendations were not strong enough.

Gary Gilbert, from the Bank Administration Institute, also noted that the Bush Commission recommendations have a few shortcomings. In particular, Gilbert finds that a clear relationship between the Bush Commission proposals and broader goals in evaluating bank regulation—protection of the nation’s money supply, preserving monetary stability, avoidance of excess concentration of financial and economic resources, and provision of adequate banking services—seems to be missing.

Several speakers at this year’s Bank Structure Conference attempted to shed some light on possible regulatory and legislative responses to the changing financial environment. Robert A. Richard, director of the Supervisory Procedures Committee at the Conference of State Bank Supervisors, believes that each state should have the right to do what it wants for its own citizens. While Richard opposes a national policy on the powers of financial institutions, he is in favor of the Bush Commission proposal to certify state banking departments. He is, however, concerned about how certification would be implemented, and with regard to the regulation of bank holding companies, Richard prefers the current system. He is convinced that regulatory reform will change the states’ role in the supervision and regulation of financial institutions. But only after such “reregulation” has begun will the direction of this change become apparent.

Lamar Smith, chief economist of the Senate Committee on Banking, Housing, and Urban Affairs, pointed out that Congress is being pressured to impose limitations on states’ abilities to deregulate product and geographic markets, but

that Congress has always been reluctant to interfere with states' rights, particularly in areas where states already have legislation. Smith guessed that Congress will continue to defer to states rights unless an unambiguous case can be made that the actions of the states were threatening the FDIC's insurance fund and would lead to potential significant financial cost to the federal government.

Research at the Chicago Fed

Indeed, the financial system is at a crossroads; very important legislative and regulatory decisions will affect the viability and strength of the financial sector and the economy for many years to come. The Conference on Bank Structure and Competition helps bridge the gap between economic theory and practice by providing an opportunity for academics, regulators, bankers, and other business practitioners to exchange ideas on pressing issues in the financial sector. The result has been better and more pertinent research on important and timely public policy issues.

Under the guidance of Karl A. Scheld, Direc-

tor of Research at the Federal Reserve Bank of Chicago, and Harvey Rosenblum, Vice President and Associate Director of Research and the host of the Bank Structure Conference, the research staff at the Chicago Fed studies, throughout the year, important issues faced by the financial community. Gillian Garcia and Herbert Baer, for example, recently examined the dynamic adjustment in the market for MMDAs and presented their findings at the 1984 Bank Structure Conference. These and others at the Chicago Fed have studied various aspects of banking deregulation, competition, and the future of the financial services industry.

At this year's Bank Structure Conference, Silas Keehn, President of the Federal Reserve Bank of Chicago, in looking back at the 1983 Conference said that "the thing that impressed me most was the fact that events that seemed incredible a year ago seem ordinary and commonplace now." Whatever lies ahead for the financial sector, whether incredible or ordinary, will be on the mainstage of coming Bank Structure Conferences and the subject of continuing research at the Federal Reserve Bank of Chicago.

— Christine Pavel

The Proceedings of the 1984 Conference on Bank Structure and Competition will be available in early Fall 1984. Copies can be obtained for a price of \$10.00 each from:

Public Information Center
Federal Reserve Bank of Chicago
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Next year's Bank Structure Conference will be held May 1-3, 1985, in Chicago.
