LOOKING BACKWARD AT THE NINETEEN-EIGHTIES

Remarks by

Walter B. Wriston

Chairman

Citibank/Citicorp

Reserve City Bankers

Boca Raton, Florida

March 31, 1980

Prophecy has been defined as "credibility packaged for future delivery." Obviously, one is better off postponing the due-date as long as possible, and it is usually safer to predict the next hundred years than the next ten. But if Bill Miller, John Heimann, and Paul Volcker are brave enough to come here and predict what the government and the Federal Reserve are going to be doing during the 1980s, I guess I can summon the courage to do a little prognosticating on behalf of bank holding companies.

Prophecying is a growth industry in America. Futurology has become a profession, and committees and institutes devoted to studying the future are springing up all over. Even

Congress has one. At the same time, the study of history is rapidly disappearing from the school curriculum and history teachers are out looking for a new line of work.

Maybe I can combine my old-fashioned views about history with the current fad of futurology by emulating the example of the writer Edward Bellamy ninety-some years ago, in his best-seller, Looking Backward. He approached a problem like this by projecting his imagination forward in time to the year 2000 and writing a "history" of everything that had happened since 1887.

Let me read one possible entry from The New 21st Century Encyclopedia--the one on commercial banks:

> Banking in the United States functioned as a separate industry from 1781,

when the first commercial bank was founded in Philadelphia, until the late 1980s, when its functions were absorbed by various other forms of financial intermediaries. Its final demise, like that of certain fossil species of animals, may be attributed to a continous process of specialization, until finally it was no longer able to adapt to rapid changes in its environment.

The specialization of depository institutions, although ultimately mandated by law, originated in the financial marketplace. The first mutual savings banks came into existence because commercial banks chose to deal only with commercial and government clients. The first savings and loan associations came into existence because both the commercial banks and the savings banks refused to make mortgage loans. The first credit unions appeared because both the savings banks and the S&Ls were prohibited from making consumer loans, and the commercial banks of the time were not interested. The first credit card was issued by others because banks refused to enter the market early. With the passage of time, these self-limiting responses to the marketplace became frozen into law, so that the commercial banks entered the 1980s competing with 28,000 other specialized depository institutions. Curiously, the commercial banks expended all their efforts on preventing other commercial banks from having an opportunity to compete, and their customers simply gravitated to other intermediaries who were more interested in obtaining their business. Very few bank holding companies proved flexible enough to adapt to the unprecedented social change that followed the combining of the electronic computer with telecommunications on a worldwide scale. The advent of electronic funds transfer and storage had as profound an effect on banks as did the substitution of paper money for bullion, but this phenomenon was not generally understood at the time. By the mid-1990s, commercial banking functions had all been replicated by such institutions as department store chains, satellite communications companies, and cable TV stations.

That's the end of the article. It's not a very happy entry, but it's easy to guess how it might have happened. All we have to do is look at what banks are supposed to be doing right now--in 1980--and then review what everybody else is doing.

Banks take demand deposits, and pay customers' checks drawn against them. So do credit unions, savings banks, savings and loans, the American Telephone and Telegraph Company, stockbroker cash-management accounts, and money market mutual funds.

Banks take time deposits and savings deposits, and pay interest on them. So do brokers, money market funds, and all the S&Ls owned by companies like Sears, Roebuck, National Steel, Beatrice Foods, and the Baldwin Piano Company.

Banks lend money secured by collateral. So do brokerage firms, leasing companies, factoring companies, captive finance companies, and aircraft engine manufacturers.

Banks lend money to businesses without collateral. So do other businesses. Indeed business firms now lend to other firms more than $100 billion in the commercial paper market.

Banks make personal loans and offer credit cards. So does everybody else, from finance companies to department store chains. In fact, bank-issued credit cards account for only about 15 percent of the credit cards outstanding in the country.

Banks deal in government paper. So do corporate treasurers, brokers, mutual funds, and the man in the street.

The list is endless, because it covers every so-called banking service. It is doubtful if any of us could come up with anything a bank can do that somebody else is not also doing--and doing nationwide. While we commercial bankers may sit around and fret about competing with each other, our customers couldn't care less. The customer wants the best deal for his money, and today that deal is no further away than the nearest telephone. Perhaps bankers have reached that point described by Karl Mannheim when he wrote:

> . . . Ruling groups can in their thinking become so intensively interest-bound to a situation that they are simply no longer able to see certain facts which would undermine their sense of domination.

Can we not see, for example, that money market mutual funds are nothing more than the offspring of a marriage between Regulation Q and the toll-free telephone? They were up to $42 billion by the end of the Seventies, and unless banks are allowed to compete, are likely to capture anywhere from one-fifth to one-third of total consumer savings deposits during the Eighties. We encouraged that marriage ourselves, with the help of Washington, and the progeny will continue dipping their hands into our pockets as long as we continue to nourish the conditions that created them. Or until the pockets disappear, whichever comes first.

It does not have to be like that. The section I read you from <u>The New 21st Century</u>

Encyclopedia does not have to be published. We are entering upon a chapter in the history of banking, the whole of which will probably be written in the next ten years, certainly within the last twenty years of this century. We are the present custodians of an institution that is as old as this country. ~~Whether it survives into the 21st century is a matter that will be determined in no small part by those present in this room.~~ There is no reason why one ~~of us~~ BANKER should someday have to write in our memoirs, as Churchill did about his failure to appreciate that Singapore was vulnerable because its guns all pointed the wrong way, "I do not write this in any way to excuse myself. I ought to have known, my advisers ought to have known and I ought to have been told, and I ought to have asked."

As bankers, we will not have even that excuse, because we ~~have been~~ told. Fifty years ago, in February 1930, the very first issue of Fortune magazine carried an article on banking containing these words, which might almost have been written yesterday:

> . . . banking has become extremely complex and has long since exceeded the old boundaries of regular banking. The General Motors Acceptance Corp., which finances your purchase of Cadillac or Chevrolet, is doing a banking business--doing it in all 48 states of the Union. The . . .

Chase National, no loud proponent of branch banking, owns the American Express Co., which, as everyone knows, no longer carries trunks on its back, but does issue travelers' checks and will soon open its own trust company. Though you should buy such a check in Oskaloosa, it is Mr. Wiggin at 18 Pine Street, New York, who is promptly in command of your money. Building and loan societies, the ubiquitous Morris Plan Banks, and such multibranched investment bankers as Lee Higginson & Co., with its 37 offices and Brown Brothers, are all interstate banks.

Even the mail order companies, through financing by deferred payments, may be classed as doing a banking business that is not halted by state boundaries. Dozens of other instances of what are practical forms of nation-wide banking could be cited--the only regulation against interstate banking is in the case of those corporations which are unfortunately chartered for the purpose of doing a banking business.

That was 50 years ago, and someone might reasonably ask how we've survived this long if the threat is that bad. One answer is that many did not. In the 1920s there were about 30,000 banks--today there are about 15,000. Those of us who remain are steadily losing our share of business. There are no reliable statistics for the pre-war years, but I can point out that in the first fifteen years after the war, between the end of 1945 and 1960, certainly a time everyone remembers as highly prosperous, the assets of commercial banks rose by three-fifths, while the assets of life insurance companies tripled, those of S&Ls multiplied by nine, and trusteed pension funds by fifteen.

We do not have to let this trend continue. Banking can recover its proper share of the marketplace--but only when we finally see the world clear and agree to abandon practices that were already outmoded 50 years ago.

When I was a boy in Wisconsin, the political power of the dairy lobby forced through laws making it illegal to put any color in margarine, in order to make it look as unappetizing as possible. Later, as consumer pressure mounted, one could buy white margarine packaged with a little bag of dye. If one had strong fingers and was truly dedicated, it could be mixed to make margarine look more or less like butter. Today, it comes pre-mixed, and margarine outsells butter by more than two to one. In banking's attempt to keep other banks out of "our" market, we are making the same losing argument that the butter lobby did, since others are now supplying not only substitute products like margarine, they are supplying what we regard as our own real bread and butter.

There have been periods in our history--not so very long ago--when political campaigners ritually looked forward to the time when the western farmer, and the small-town businessman, and the small investor, might have the same access to money and credit as a Hamilton or a Biddle, or a Morgan. That time is now here. The technological conditions for fulfilling those promises now exists. If bankers do not do it, others will. If history proves anything, it's that the market will not take "no" for an answer.

Let me describe the bank of the future:

- It will take your funds for deposit and pay you close to money market interest on them, up to the minute you take them out, by check or otherwise.

- It will give you medium or short-term loans, or a mortgage on your home.
- It will invest your surplus funds in anything from gold and real estate to commercial paper, commodities futures, or the stock market.
- It will insure your life, your mortgage, or your business.
- It will underwrite stock issues for that business, or negotiate a private placement, or arrange a merger.
- It will do all this electronically in most major cities of the world,

and it will let you take your account with you wherever you go. In fact, the bank of the future will help you sell your old house and buy a new one somewhere else simultaneously.

The bank of the future will do all this because the customer of the future will be satisfied with nothing less. And the customer already knows that he can demand all this because the bank of the future that I have described already exists. Don Regan runs it, and it's called Merrill Lynch, Pierce, Fenner & Smith. I, for one, applaud him for it.

The author of the article describing these and all the other wonderful services available from Merrill Lynch speculated that they would "clearly like to see Glass-Steagall drastically modified if not entirely repealed" in order to pave the way into commercial banking. I wondered why. Surely it must be obvious by now that the wall built by Glass and Steagall and their friend McFadden to keep people out of the fort is today serving an entirely different purpose. All it does now is keep the bankers locked inside while everyone else with imagination and drive harvests the cash crops growing beyond the stockade.

What is harder to understand is why, whenever parts of the wall show signs of crumbling, bankers themselves are first on the scene to mortar it up. And no one ever seems to notice that the circumference of Fortress Banking keeps getting smaller and smaller. In 1946, we had a 57 percent share of the financial assets of the country; last year it had shrunk to about 38 percent--and it is still shrinking.

We have the spectacle of bankers in one state, in the face of an opinion of a former Solicitor General of the United States, asking their state legislature for a law prohibiting out-of-state bank holding companies from opening any offices in that state. We find bankers in another state standing before the Supreme Court in an attempt to overturn a three-judge District Court ruling that it is unconstitutional for one state to bar trust companies owned out of state from doing business in their area. The Senate of the United States, propelled by 32 state bankers' associations, passed the Stewart Amendment to prohibit the Comptroller from permitting limited-purpose national banks to do out-of-state trust business. While all this is going on, National Steel Corporation buys a Savings and Loan Association in California, American Express buys 50 percent of Warner Communications, Merrill Lynch opens ten new offices in your town, and we bankers stay in our bunkers with our backs to the wall, resolutely talking about keeping fellow bankers out of "our markets."

Those people on the outside of the wall--Merrill Lynch, Sears, Roebuck, G.E. Credit Corporation, the credit card companies, and all the others--are only doing what a market economy demands. All they are doing is giving the ordinary consumer a competitive return on his money. There's nothing wrong with this;

what's wrong is the government's attempt to prevent it. And if we encourage these attempts as many of our colleagues have done, then, as Pogo said, the enemy is us.

All attempts to protect our Fortress Banking will fail, because new technologies like telecommunications and data processing have provided the means to give everyone equal access to the free money markets, and inflation is furnishing the incentive to go there. That's what plastic credit cards and toll-free 800 numbers are really all about. The trend cannot be halted because the public, in this age of consumerism, will no longer accept the inequities. Banks cannot be sheltered from this competition; they can only be banned from participating in it. Indeed, it is useless to anticipate, if we are forbidden to act. And if we do not participate, we are finished as financial intermediaries. It may not be an exaggeration to say that our very survival in the year 2000 may entail giving up our banking charter, if our laws and regulations do not change.

Every lending officer ~~in this room~~ is familiar with the company that fails to adapt to new realities and thus produces a write-off for the bank and becomes another tombstone in the corporate graveyard of America. No one here was around, but we have all heard the story of how Central Leather, once larger than General Motors, failed to adopt new shoemaking equipment and so is no longer alive, let alone the 24th largest corporation in America. Some of us here saw how Curtiss-Wright, builder of the famous P-40 fighter plane, failed to see the demand for jet planes after the war and so is no longer bigger than Boeing or Lockheed, as it was in 1946. All of us here are well aware of Chrysler. We can make our own personal list of companies, and indeed of industries, that failed to provide the service or the goods that people wanted to buy, and so are no longer around. If a given company or industry will not supply goods or services at a fair price, the customer will go elsewhere.

Sometimes the managements of the companies in an industry fail to understand what business they are in, as many railroads failed to understand that they were in the transportation business, and so they failed or disappeared entirely. Sometimes the managements fail to give the customer what he or she wants--like paying 5 percent on savings accounts in a 12 percent market, to pick a random example. Sometimes the companies and their regulators fail to reflect the new realities of the world, and whole industries die as unfettered competition comes into the marketplace and runs rings around them. The view of the U.S. Government expressed by courts and regulators that savings banks don't compete with commercial banks can only be described as bizarre. It's like believing the railroads were a monopoly long after the tracks had rusted, and the buses and the 18-wheelers were rolling down the interstate highways with the 747s flying overhead.

Some of our own banking colleagues, like generals preparing for the last war, still think of Fortress Banking as a separate line of commerce. Sometimes the very executives who bring the crowd at the Lions Club luncheon to its feet applauding, with a ringing defense of free enterprise, go back to their offices and get on the phone to persuade their congressmen or regulators to protect them from competition. Whatever the reason, history teaches that companies disappear when they fail to adapt to new realities.

The question as we enter the 1980s is not how many people will climb over "our" wall into "our" market, but whether we will allow ourselves to climb over it, out into the sunlight where the customers are.

I would like to see that 21st century encyclopedist forced to rewrite our obituary. Whether he does or not will depend on a number of critically important political decisions that will be made during the 1980s concerning our financial system.

The business of financial intermediation is becoming a high-technology industry, and it is one complicated by political and regulatory factors. Segregated markets now exist only in the minds of people who do not live in the marketplace. Indeed the only place you can live and make that judgment is in the past. Sometimes the nonexpert says it best. Gertrude Stein was certainly not an expert in finance, but she understood better than anyone what I have been trying to say. "The money is always there, but the pockets change; it is not in the same pockets after a change; and that is all there is to say about money."