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N.C. Savings and Loan League

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ECONOMICS

Introduction:

The 1980's have begun like the first blast of a cold shower in the early morning; shocking us out of drowsiness, and confronting us with the chilling realities of a changing world. In this decade we Americans will be forced to make tough choices, and meet complex new challenges. We live in a volatile world with no time for complacency.

Obviously, this alarming truth confronts us most dramatically and dangerously right now in the field of foreign and military affairs. But I would suggest that we have also been living in a volatile world economically, and that fact is painfully self-evident to all who attempt to earn their livings and serve their communities through savings and loan associations.

This past decade has been a time of enormous change for financial institutions, and for the saving and loan industry in particular. There is little doubt that the 1980's will continue to be a time of even greater challenge and change.

In any period of change, I believe we need to keep our heads about us, evaluate proposals carefully, act cautiously, and keep our basic principles firmly in mind. This is true in foreign policy, and it is equally true for proposals which would drastically alter our basic system of financial institutions. I think we need to keep firmly in mind the basic fact, that after all is said and done, S&L's remain our nation's primary public policy instrument to maintain an adequate flow of credit for home ownership. Savings and loans are still the most effective tool we have for carrying out our nation's housing policy. And I believe the 1980's should be a time to renew our basic commitment to the notion that Americans are going to remain a nation of homeowners.

In the time we have this morning, I want to discuss briefly the chronology of proposals for changes in financial regulation, the legislative events of last year, and the outlook for Congressional action this year.

Review of Financial Reform Proposals:

When Norman Strunk appeared last month before the House Financial Institutions Subcommittee on behalf of the U.S. League of Savings Associations, to discuss Regulation Q, he said, "It seems that I have testified in this room on this subject at least a dozen times, including the first period of disintermediation in 1966 when the Regulation Q authority was extended to include savings and loan associations and savings banks."

I have often felt a bit like Norm Strunk as I have sat in the Senate Banking Committee for the past six years. But these issues have been with us for much longer, going back as early as 1958. In that year, the first major study of financial reform in the postwar era in the United States was undertaken by the Commission on Money and Credit (CMC), a private group established by the Committee for Economic Development. The CMC Report suggested a liberalization of the regulations that governed different intermediaries, and called for allowing greater portfolio flexibility for thrift institutions.

The CMC Report was the most comprehensive overview of the financial system produced up to that time. However, the total reform package was never seriously considered for implementation. The major reason was that the financial system, especially housing finance, was not perceived to be in any great difficulty at the time the report appeared. Thus the recommendations of the commission never got the political support they needed to become law.

But by the mid-1960's, serious strains in the financial system had appeared.

In 1966 deposit rate ceilings at commercial banks were lowered; ceilings were extended to thrift institutions, with the thrifts allowed to offer a higher rate than commercial banks.

Again in 1969 interest rates rose sharply. Again, a large decline in housing activity occurred, and a panel was appointed to examine the flexibility and soundness of the financial structure. The panel, the presidential Commission on Financial Structure and Regulation, was charged with the duty of assuring that the nation's financial system would be able to respond to shifting needs while maintaining economic soundness.

The report of the commission, commonly called the Hunt Commission Report, recommended many of the same proposals advanced ten years earlier by the Commission on Money and Credit.

The Hunt Commission Report was followed in 1975 in the Congress by a House Banking Committee study, specifically by the Subcommittee on Financial Institutions, known as the FINE Study, the acronym drawn from Financial Institutions and the Nation's Economy.

In that year, 1975, the Senate passed a Financial Institutions Act, authorizing many of the features contained in its successor bill of last year, the Depositiory Institutions Deregulation Act, which passed the Senate as H.R. 4986, and is still in conference with the HOuse. H.R. 4986 was bolstered by and drawn from the report of the President's Inter-Agency Task Force on Regulation Q issued in August, 1979.

Consequently, there is considerable speculation in Washington at this point, that March will likely be a time of action on financial institution issues. As with everything in Washington, however, we will have to wait and see.

Morgan Role on H.R. 4986:

I have viewed the whole trend toward what I have called the "homogenization" of financial institutions with a great deal of concern. I am skeptical of various proposals which have been put forward and passed. I fear we will end up making all financial institutions more or less alike, and that open competition might very well spell the end of the S&L industry as we have known it, and that in the process, we may well destroy the system which has served homeownership in our country so well.

During the Banking Committee's hearings, I asked then Secretary of the Treasury Blumenthal what distinctions would remain between S&L's and commercial banks. The Secretary answered that as far as functions and powers were concerned, S&L's and banks "will be much closer together." Under this bill, he said, "the distinctions would certainly be narrowed."

But one of the most eloquent statements of my concerns on this matter came during our Committee mark-up by the sponsor of the bill itself. Senator Cranston moved to exempt the S&L's of his own state of California from the NOW account provisions of the bill.

Senator Cranston, who chairs the Financial Institutions Subcommittee said:

> "My reason for offering this is as follows: The overwhelming number of thrift institutions in the country, as I understand it, do not want NOW accounts. The U.S. Savings and Loan League opposes them. They feel they are too expensive, that the thrift institutions will have to gear up to compete with banks and that will be expensive, and I think there is virtue in keeping differences between different types of financial institutions, between banks on the one hand and S&L's on the other.
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> "As an example, there's strength in diversity. If all the financial institutions become identical in their powers and all the things they can do, a strong few will soon dominate the entire industry. Community-based home-owned institutions will vanish from the scene."

So I spent hours on the Senate floor late last year leading what was at times a lonely effort to moderate and improve a bill that I believed could have had disastrous consequences for the S&L industry if enacted in the form in which it was reported by the Senate Banking Committee. I believe we achieved some significant results.

Recap of Amendments to H.R. 4986:

At the very least we forced a number of Senators to stop and think about the bills, and to realize that significant and far-reaching policy decisions were being made.

But we also had some victories. I believe we made the bill more tolerable in several significant ways.

1. Money Market Certificates: The bill contained Senator Proxmire's amendment mandating a reduction in the denomination of a money market certificate from $10,000 to $1,000. I heard from most of you, and from S&L's all around the country making it very clear that such a move would put many S&L's straight out of business. We succeeded in forcing a compromise which allowed the regulators wide latitude in lowering the denomination, when it becomes "economically feasible" to do so.

2. Residential Real Estate Lending: We passed an amendment granting authority to the Federal Home Loan Bank Board to grant residential real estate lending powers for federal S&L's comparable to those already possessed by national banks; this is in addition to, and not a substitute for, authority already contained in the Home Owners' Loan Act.

3. Insurance Reserves: I offered an amendment which was adopted allowing the FHLBB to vary the Federal Insurance Reserve at FSLIC-insured S&L's in a range from three percent to no more than six percent. It is my understanding that S&L's have been the only financial institutions to have to operate under a fixed statutory insurance reserve requirement, and I consider my amendment significant.

4. Mutual Capital Certificates: I joined with Senator Stone of Florida in offering an amendment allowing federal associations to issue mutual capital certificates, a move I hope will help to alleviate the capital crunch many mutuals are experiencing.

5. Study on Non-Economic Portfolios: We also mandated a study by a Presidentially-appointed interagency task force to report within 90 days of enactment on the problems of S&L portfolios which consist largely of non-economic and low-yielding mortgages.

6. Other Actions: These are some of the amendments of direct importance and benefit to S&L's in which I had a personal role. Additionally, I attempted to substitute for the whole bill a les far-reaching version, and attempted to give each state the authority to decide whether to allow NOW accounts. On both those efforts we failed. However, I did also succeed in stripping the bill of a provision I found particularly obnoxious. That was

the provision giving the Federal Rserve System authority to require reserves of all depository institutions offering NOW accounts.

This whole question of Federal Reserve membership remains one of the key sticking points in any future conference. I have taken the position that we should not grant the FED power to require reserves of non-member institutions and that to do so would be only one more big step in the direction of centralized federal control, further weakening state authority, and further eroding our dual system of financial institutions. My vote is seen as a pivotal vote on the Banking Committee, and I am under a great deal of pressure to change my mind, but I am not yet persuaded that I am not dead right in being very skeptical of increasing federal authority.

Outlook for the Conference: Regulation Q

We will have to watch carefully as the March 4th date for the conference on H.R. 4986 approaches. As you, of course, know, Congressman St. Germain of the House Financial Institutions Subcommittee has proposed a five-year extension of Regulation Q which has the support of the U.S. League.

As Norman Strunk of the League pointed out before the House Committee:

"It is useful to ask ourselves exactly why the Q law has been extended so often and why it has not been allowed to fade away. The answer basically is that there has not been enough interest rate flexibility on the asset side of our balance sheets to permit our housing-specialized institutions to compete head-on in free-market competition with the commercial banking system in periods of high and rising prime rates as charged by the commercial banks. We have not had the ability year-by-year to earn market rates on our assets which, of course, is a prerequisite for paying market rates year-in and year-out to our depositors.

Put more simply, Regulation Q

"was intended to preserve the savings and loan associations and the savings banks and thus our home-financing system from being destroyed by a much larger and very competitive commercial banking system."

I believe it is clear that Regulation Q will continue to be needed as we move through a difficult transition from a controlled environment to a market-rate environment. We must not act precipitously in removing the kinds of protections needed to ensure the viability of the savings and loan industry in what will likely be a painful time for many institutions.

Other Concerns: Earnings and Tax-Incentive for Savers:

Before closing, I want to touch on two very important topics, the earnings picture for S&L's and the question of encouraging savings via a tax incentive.

Earnings: Talking with S&L people all over the country, one hears a pretty bleak picture of the earnings picture for the near-term future. Many predict negative earnings, and many raise the spectre of a large number of institutions going under. I believe the Congress has to be prepared to act in a responsible way to avoid large numbers of failures. It is my understanding that the U.S. League is presently working on proposals for tax-treatment of earnings to ease the picture for those institutions which may find themselves in serious trouble, and is also looking at what the private sector can do on its own. I believe this is the way to proceed, and I look forward to receiving and evaluating the League's proposals. Just as I opposed the Chrysler "bail-out", I believe I would have to oppose any simple bail-out for S&L's. I welcome the League's initiative in this area.

Tax-Incentive for Savers: Throughout the entire last year and the clamor for relief for "small savers", I have felt that we should proceed to offer a tax-incentive for savings, rather than forcing institutions to pay market rates on all deposits. I was an original cosponsor with Senator Bentsen of Texas of the proposal which is now in conference on the windfall profits tax bill -- in a scaled-down form from our original proposal -- which would exempt the first $200 in interest or dividends ($400 for a joint return) from taxation. The issue remains unresolved in the conference, and will be addressed again this week. I do feel confident that something will emerge and become law this year. It will not be as big a step as I would have liked, but it is a step -- and a significant one -- in the right direction. We now have a situation where economic forces are pushing people to spend rather than save, and we have to change that. The latest figures I saw show that Americans save only four percent of after-tax income, the lowest rate in decades. That compares with 25 percent for the Japanese and 18 percent for the Germans. If we are to return our economy to a healthy rate of growth and increase "real" wages and incomes, then we simply have to reverse the trend toward undersaving and overspending.

Conclusion:

In this way, a tax-incentive for savers is also symbolic of the need to change the whole direction of our economy -- by balancing the federal budget, and by coming to grips with the inflation which threatens to undermine much of the basic social foundation of our country. We need to encourage people to plan and save for the future again rather than continuing what I fear is a widespread attitude these days, an attitude that says, "Buy now -- on credit -- Things will only get more expensive." That is an attitude which will eventually catch up with itself, just as will a similar attitude on the part of the federal government.

Despite the shocks and shakeness with which the 1980's have begun, I believe this can be a decade of growth and prosperity for our country and also for the savings and Loan industry. The demographers and economists tell us that some 42 million people will turn 30 years of age between now and 1989, creating an unprecedented demand for housing. In short, the baby boom has grown up. I deeply hope that the savings and loan industry will be there, maintaining the same traditional commitment to housing, which enabled the parents of the new generation of young adults to achieve and enjoy the benefits of home ownership.