Remarks by

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This afternoon, I'd like to discuss with you the issue of financial modernization. This is a topic of great importance made even more pressing by technological change and the increasing globalization trade. In addition, as most of you know, Congress is once again in the midst of considering financial modernization legislation -- something it has done every few years since the early 70s.

Now, if the history of legislative efforts in this area is any guide, financial modernization will not occur as quickly as many would like. But I didn't come here today to dissect the complexities of the legislative process or discuss the odds of getting a favorable bill out of Congress. Rather, I want to raise a broader question for us to consider: Why do we continue to use a term as impressive as "financial modernization" to describe what is in today's world a rather narrow set of reforms centered on repeal or amendment of the Glass-Steagall Act?

In my view, financial modernization should not be a synonym for narrow reform. Indeed, I believe that financial services policy makers, the banking industry, and many of those who study and write about public policy in the financial services arena -- in focusing so narrowly on Glass-Steagall reform for so many years -- have failed to address more compelling public policy questions . . . questions that, as a nation, we must ultimately address to truly modernize our financial system.

In short, it is time to think anew about the conceptual content we assign to "financial modernization" -- an issue that could impact considerably our country's economic prosperity and global competitiveness in the next century.

Twenty five years ago, this country tried to take advantage of a period of banking industry strength to reform and modernize financial services in a comprehensive way. In 1971, the Hunt Commission urged us to -- and I quote -- "move as far as possible toward freedom of financial markets and equip all institutions with the powers necessary to compete in such markets."

Twenty-five years later, that still sounds like good counsel. Over the years, many bills have advanced under the banner of financial modernization. Few of much significance have passed. Banks still operate within walls constructed in the 1930s. And as the years roll by, the Hunt Commission's observation, that banks have product and market specialization forced upon them by arcane statutes and rules, becomes more true all the time.

A generation of banking industry leadership has now spent much of their political careers and political capital battling over Glass-Steagall reform -- sadly, to little effect. But let's suppose for a moment that Glass-Steagall reform passes tomorrow. Would we then judge the past twenty-five years of political capital well spent? Could we then breathe a collective sigh of relief knowing that -- modernized at long last -- our financial system is now prepared to carry America's economy forward into the next millennium?

We must stop fooling ourselves. Yes, Glass-Steagall reform would be a good thing for those banks seeking to enter more deeply into the securities business. And, yes, properly executed, Glass-Steagall reform is good public policy. But to say that passing Glass-Steagall reform would modernize the financial system is like saying that plowing one lane on Massachusetts Avenue completed Washington's snow removal effort.

My point is this -- Glass-Steagall reform may be a good thing, it falls considerably short of real financial modernization. And what I find discouraging is that -- by focusing so much attention on Glass-Steagall reform -- we are failing to deal with other issues even more central to modernizing our financial system.

The banking industry runs the risk of spending an enormous amount of its political capital to reform one corner of the world, while most other -- even more critical -- segments of that world are rapidly changing and in desperate need of attention. Banking industry leadership and policy makers should be vigorously addressing the new realities of the new environment -- an environment being shaped by technology. Technology, what Alvin Toffler has called "that great growling engine of change," is changing the face of banking and financial services, and changing the way consumers purchase goods and services of all types. If Glass-Steagall reform was the major financial modernization issue of 1971, the financial modernization issues of today and tomorrow will flow from the technological revolution in financial services.

Our ability to bring banking and financial services into the 21st century will determine how fast and effectively we realize technology's vast, still untapped, potential to fuel economic growth and opportunity for American businesses and consumers.

Consider these numbers. In the next five years, media and telecommunications companies plan to invest upwards of $70 billion dollars to bring a truly customer-friendly Internet to millions of households. Already, nearly every Fortune 500 corporation is connected to the Internet, and 85 percent of companies with sales of $300 million or less are developing connections. By one estimate, there will be 200 million

Internet users in the year 2000. Experts believe electronic commerce -- $245 billion today -- will account for nearly $3 trillion by 2005.

And the Internet is only the tip of the iceberg. Totally electronic market trading, e-money, a paperless payments system, vastly more sophisticated risk pricing and risk control models are all on the horizon. Just think about what the tremendous increases in computer power has meant to an information-intensive business like banking. Every 18 months, the cost of computing power halves, or -- put another way -- we can buy double the computer power for the same dollar -- every year and a half. Just think what that's meant. When personal computers entered our offices and homes in a big way in the early 80s, their floppy disks held 180,000 bites of information. Today's standard personal computers feature CD-ROMs that hold over half a billion bites -- on disks the same size.

Given this onslaught of technological change, these are the $3 trillion questions: What will it take to reap the benefits of what Bill Gates calls "friction-free capitalism," where even the most humble of businesses have the opportunity to reach a worldwide market through electronic commerce? What will it take to realize the enormous potential continuing technological innovation offers?

A key part of the answer lies in what consumers of all eras have always demanded -- confidence in a payment system that offers security and guarantees privacy. America's banks -- guardians of consumer confidence in their economic system for decades -- should have a pivotal, leading role in realizing the potential electronic commerce holds. But it's ironic that banks, which can give consumers and merchants the confidence to realize technology's potential, expand markets and provide businesses new opportunities, have -- for much of the past 25 years -- been on the receiving end of technology's growing influence.

Technology has proved a great leveler, blurring the distinctions between the products and producers of financial services and unleashing intense globalized competition between banks, non-banks and international financial institutions. The extent of that leveling is apparent when one considers the contestants in the current gold rush surrounding the development of new electronic money and payment technologies. A casual observer might expect banks to be leaders in this race. After all, we're talking about money and payment -- the very stuff of banking. But while the contestants do include a few banks, at least equally prominent are scores of non-banks -- software producers, telecommunications firms, and so forth.

Consider stored value cards. For those of you unfamiliar with the concept, a stored value card is a prepaid card used to purchase goods or services. Rudimentary stored value cards have been used in this country for years. Some of you may have even used one today in the form of a Metro farecard. Right now a number of firms are racing to bring far more sophisticated stored value cards to market -- cards that could be used not just in limited environments like subway systems, but more widely to purchase goods or services in both physical and virtual locations -- the marketplace and the marketspace. The competing stored value cards differ in their particulars, but one difference is especially important: some -- not all -- of these products would be issued by nonbanks.

Think about that for a moment. Suppose for $100 you buy a stored value card from a non-bank, usable to purchase a wide range of goods and services. Unlike a bank, that non-bank faces no minimum capital requirements, no liquidity standards. If it fails before you spend the value stored on your card, your card may be worthless and you may be out of money. No deposit insurance here.

I'm not here today to suggest that non-banks shouldn't be in this business; there are serious arguments on both sides of this issue. My purpose at present is to assert a much simpler point: if you share my belief that electronic commerce will grow rapidly, and that new payment technologies will grow along with it, you should recognize that the prospect of non-bank issuance of electronic value presents public policy questions -- specifically, financial stability and consumer protection questions -- of considerable importance. More important from the banking industry's perspective, perhaps, non-bank issuance of electronic value could present the banking industry with a competitive inequality far more significant to a far larger class of banks than anything now troubling the proponents of Glass-Steagall reform.

Another question critical to the industry's future is the geography question.

Since its inception, this country has been committed to a legal infrastructure that ties the activities of all manner of banks closely to state laws. Even national banks draw many of their authorities from state laws. Technology has put this legal infrastructure under increasing strain. For example, who should we say has jurisdiction over a loan issued by a depository institution with offices in State A to a consumer in State B applying via a Web site maintained on a server in State C? You can make up rules based on geography, but an answer derived from any set of geography-based rules will seem arbitrary, diminishing the credibility of the legal regime.

In addition, financial markets are in fact steadily becoming more and more international. And though, to be sure, it has its own complexities, the regulatory regime established by the European Union may well turn out to be less complex and therefore more efficient than the complex system of bank regulation and supervision we have built up here in America. As international competition continues to intensify, that difference in regulatory efficiency will become a competitive disadvantage for American banks.

And putting further strain on the question of geography is the breakneck speed with which America's depository institutions are consolidating. A consolidated industry appears unlikely to support the full regulatory infrastructure of the existing system. Moreover, as significant numbers of multi-state branch banks come into being under the Riegle-Neal Act of 1994, they are likely to become a potent political force for harmonizing the current legal differences between the laws of different states and between state and federal laws. Already, twenty states have exercised Riegle-Neal's early opt-in. The trend toward interstate branching is clear and will certainly gain even greater momentum in the months ahead.

Again, I'm not here today to argue for or against the pre-emption of state laws. My point again is the much simpler one that the world is changing whether we like it or not. The impact of these factors on bank operations and the operation of the bank regulatory and supervisory apparatus presents issues of critical importance to the entire banking industry -- issues that have everything to do with financial modernization in any meaningful sense of the term, but that Congress and the banking industry have not yet begun adequately to address.

The question of non-bank involvement in the issuance of stored value and what I have called the geography question are not, I'm sure, the only financial modernization issues going unaddressed at present -- nor perhaps even the most critical. In my opinion, however, each of these probably have greater relevance to the future of the banking industry than anything currently or recently considered by Congress under the financial modernization label. The fact that these questions are not being addressed demonstrates clearly the danger of allowing our concept of financial modernization to ossify. A financial modernization agenda that, if accomplished, would bring the banking industry current circa 1971 forms a strange centerpiece for the 1996 deliberations of policy makers and industry leaders.

With or without Glass-Steagall reform, we need to move on to what are clearly the more critical issues for the banking system. I know some will fault this perspective as hopelessly out of step with political reality. Given how tough it's been to fight the battles of Glass-Steagall reform, how could we ever hope to move the ball forward on issues of even greater significance? How could we ever hope to work through the maze of issues that pits the banking industry against non-banks?

But neither policy makers nor the industry leadership can afford to be captured by the sort of inside-the-Beltway reasoning that says we should focus on the politically doable instead of the economically necessary. We must address -- not ignore -- the critical problems we face, and we must work together to make it politically realistic to do so. So let's step outside this Beltway mentality and forget -- for a moment -- what may or may not be politically doable at this moment.

Let's, instead, talk candidly about what we must do.

First, we must give thoughtful consideration to the kind of financial services industry the country and the economy needs in the next century. We need to abandon the narrow, protectionist, special interest-driven way we've viewed the future of financial services in America. For too long, the players in the policy making drama have negotiated market restrictions and regulatory frameworks -- not on the basis of market realities and the level of risk -- but like barters at a trading bazaar.

Second, we must adhere to free market principles in creating the industry of the future. Even the truest of believers in the power of the competitive free market have trouble putting its theory into practice -- particularly when it runs counter to the entrenched interest of their allies. However, I'm convinced that this model gives us the best chance of building a financial services industry capable of maximizing consumer benefits and helping the American economy compete internationally.

Third, we must also recognize that, in fact, government regulation plays a critical and necessary role in helping the market work efficiently, ensuring safety and soundness, protecting consumers, and stemming systemic risk in the entire financial services arena. Responsible regulation is perfectly consistent with, and may even be essential to, a wide scope for market operations. However -- and this is to my mind a critical however -- striking the proper balance between necessary regulation and uncessary burden is essential and requires an elevated discussion of what is and what isn't risky -- a level of thought and analysis that goes beyond myth or gut instinct. Institutions that do precisely the same business are, today, regulated quite differently. And that is not acceptable. Many institutions face multiple federal and state regulatory bodies -- a hydra-headed monster that requires legions of lawyers and compliance officers to combat effectively. If this regulatory morass is not made more rational, banks in particular will find it increasingly difficult to compete on equal footing. In a highly technological world where efficiency ratios become even more critical to success, regulatory overload and imbalance will be a fundamental issue of bank survivability.

In summary, America needs and deserves a thorough, thoughtful debate on how best to create a truly competitive, high-tech, safe and sound financial services industry and economy.

And, I am convinced we can indeed create the kind of financial services system the American economy needs -- one that is efficient and dynamic, one that is the world's leading competitor and one that is capable of fostering growth and opportunity for businesses, individuals and communities. That is what financial modernization should be about and what it must help accomplish in the months and years ahead. We must not miss the opportunity to promptly address and achieve genuine financial modernization.

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