

MEMO# 4288

December 1, 1992

ARTICLE ON CHANGES IN FINANCIAL INTERMEDIATION

December 1, 1992 TO: BOARD OF GOVERNORS NO. 86-92 RE: ARTICLE ON CHANGES IN FINANCIAL INTERMEDIATION _____ At the October Board meeting, I reported that due to the growth of mutual funds and problems in the banking industry, there is an increasing likelihood that suggestions will be made to impose bank-type regulation on mutual funds. Attached is an article by Gordon H. Sellon, Jr., an assistant vice president and economist at the Federal Reserve Bank of Kansas City, which appeared in the Bank's Third Quarter Economic Review, entitled "Changes in Financial Intermediation: The Role of Pension and Mutual Funds." The article states that "banks and thrifts have been adversely affected by the growth of pension and mutual funds", and that "by altering the roles of traditional intermediaries, pension and mutual funds have....contributed to the increased instability of financial markets in recent years. These changes in the intermediation process raise important questions about the future regulation of financial intermediaries." The article concludes by stating that: A closely related issue is whether regulation should be harmonized across competing intermediaries. Differential regulation was possible in the early postwar financial system because of the specialization of intermediaries and absence of direct competition. In the current environment where specialization has broken down and intermediaries desire to perform a broad range of financial services, differential regulation may no longer work. In the current system, it may not be possible to regulate one intermediary that offers many of the same services as an unregulated intermediary. Continuing differential regulation may put some intermediaries at a competitive disadvantage, increasing the likelihood of failure and decreasing the stability of the financial system. * * * We will keep you informed of developments. Matthew P. Fink President Attachment