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It is particularly nice to have an opportunity to speak to you at Bretton Woods, a location steeped in so much economic history. The signers of the Bretton Woods Agreement faced the challenge of rebuilding the world's economies after World War II. Their success set the stage for a remarkable period of U.S. and European growth during the next 50 years. Similarly, I believe the actions taken in the early 1980s to address the issue of inflation in this country set the stage for what has been a remarkable 15 year period of growth, with time out only briefly in the early '90s for a recession, remarkable both for its depth here in New England, and its relative mildness for the country as a whole.

At present, the national economy is amazingly robust; the stock market is fluctuating around record highs; the unemployment rate is as low as it has been in more than 20 years, and consumer confidence recently reached a 28-year high. New England too is on a roll, with unemployment below the nation's level, steady job growth, a resurgence of civilian business in former defense factories and, in some areas, tight commercial

real estate markets. The good news on the economic front is reflected in the strong results for the banking sector. Banks are so well-capitalized that some banks are buying back shares, lending remains vigorous, and many bank stocks are trading at record highs. With such good news about both the national economy and the banking sector, one might wonder if we should dispense with the talking and just head to the 19th hole to celebrate. However, as a central banker, while I can relish today's celebration, I am also acutely aware that too often it leads to tomorrow's hangover.

At this late stage of a recovery, it is unusual to see growth as strong as it has been over the past two quarters. Consumers are one of the major sources of this growth, with real consumption over the past four quarters up well over 3 percent. Consistent with this strong growth, banks have been lending aggressively; consumer loans were up 5.4 percent last year and consumer credit card lending grew even faster, at 8.3 percent. The other major source of recent strength has been business fixed

investment, which grew more than 9 percent over the past four quarters. Similarly, commercial and industrial lending was up 6.4 percent last year and commercial real estate lending grew by 6.6 percent.

Strong growth is welcome, but we must remain watchful that the headiness of the '80s does not creep back into loan underwriting. Despite stories about the terms being offered by the bank down the street, it is unlikely that underwriting standards in New England have seriously deteriorated. Until lately loan growth has been less robust here than for the nation. I am concerned, however, that other financial institutions may be letting underwriting standards slip for both consumer and commercial real estate loans. While credit to qualified borrowers should be encouraged, neither the borrower nor the lender benefit from financing that cannot be sustained by an individual's likely income or a business' likely cash flow.

Most of us in this room saw some difficult times in banking during the late '80s and early '90s. Today, we see loan loss

reserves and bank capital in U.S. institutions at their highest levels in almost 50 years. Importantly, the banking system has repaired itself without cost to the taxpayer -- because our system has worked as it was designed to work. It is surely the most flexible, resilient and innovative banking system in the world, and the relatively small institutions that are represented here today are at its core. What distinguishes the structure of our banking system from that of other industrialized nations is the sheer number of institutions -- somewhere in the area of 7,000 separate banking organizations, not to mention thrifts, compared to a total of fewer than 500 banks incorporated in England, Germany and Canada combined. The advantage of our system is that a more diversified banking structure reduces risk to the system as a whole, just as a more diversified loan portfolio reduces risk to an individual institution.

As you might imagine, our decentralized, diverse banking structure is closely geared to our market economy and the small average size of our nonfinancial business enterprises. Particularly

in areas such as northern New England, the importance of community banks can hardly be overstated. The many small businesses that characterize this region generally do not have access to capital markets and must rely on banks as sources of capital. These small businesses are then able to put that capital to work by converting individual creativity to new jobs, playing a major role in fueling economic growth.

To be sure, large banks are also capable of serving the needs of the businesses and consumers of northern New England, and with the onset of interstate banking and branching, they have more opportunity to do so. However, our research indicates that when a large bank enters a market by acquiring a smaller institution, the combined institution's small business lending initially declines. Other banks in the community then pick up the slack and take on some of the customer base that is lost by the newly acquired bank. Often a new bank is formed to fill the void left by consolidation. Community banks have the networks to readily identify customer needs and the agility to respond to them.

As a matter of fact, the CEO of a large regional institution told me quite candidly that there is no way that his organization can compete in a given area with a well run community bank.

As a result, I am confident that interstate banking poses no immediate threat to any institution by virtue of increased competition, so long as the playing field is level. The Federal Reserve has supported the interstate initiative from its onset and the states of Maine, Vermont and New Hampshire have all opted in -- recognizing the benefits to be gained by consumers as well as banks. In moving to an interstate banking environment, however, an imbalance was created between state and national charters for any organization choosing to expand beyond state lines. The consequence, unless there is a harmonization of state banking laws and regulations, is a very real threat to the continued viability of the dual banking system. And that is a matter that concerns me very much due to the implications for the economy in general, not just for banks.

The dual banking system has served this country well. Just as large numbers of small banks are key to the strength of our economy, the choice of banking charter is integral to the strength and flexibility of the banking system -- for two reasons. First, the states have indeed served as "laboratories for innovation," a phrase I think of in quotes because it is used so often. The reason for its frequent use is that it is true. The NOW account and the variable rate mortgage were invented at state-chartered banks. The 1994 interstate branching statute originated in state laws that permitted cross-border banking, starting with the rewriting of Maine's banking laws in the 1970s. And now Maine has developed another innovation, a universal charter that allows state-chartered commercial banks, savings banks, and thrifts to share powers that previously were unique to each charter.

The second important function of the dual banking system is to serve as a safeguard against rigid or capricious federal regulation. For example, the potential exists for a single federal regulator to become so focused on risk reduction, that it becomes

insensitive to the needs of the marketplace and loses sight of the fact that a bank's mission is to assume risk. By having a choice of charter, a bank may always elect to change charters and thereby change primary regulators. In that way, the dual banking system provides for checks and balances that are beneficial to banks and therefore, to the economy as a whole.

We at the Federal Reserve have been working with the states to ensure that state banks are not disadvantaged in an interstate banking environment. I chair an internal group of supervisory, operations and legal staff from around the country who have been meeting regularly for a year and a half to develop plans and processes to ease the transition for Reserve Banks and commercial banks alike. We have revised our internal policies and procedures to accommodate banks that operate in more than one Federal Reserve District and we have actively supported the "home state rule," now contained in a bill filed by Rep. Marge Roukema that would amend the Riegle-Neal Interstate Banking Act. This legislation would put state banks on an equal footing

with national banks with respect to branch activities in a host state. In addition, we have been active in the State-Federal Working Group, consisting of representatives from the states, the Federal Reserve, the FDIC, and the Conference of State Banking Supervisors. This is the group that has developed the State/Federal Protocol -- a working agreement whose purpose is to provide for the "seamless" supervision of all state-chartered banks, including those that branch across state lines. That means a single point of state contact, a consistent framework for examinations among the Federal Reserve, the FDIC and the states, and the use of alternate or joint examinations.

The seamless supervision of state banks focuses on easing burdens placed upon banks operating in more than one jurisdiction, through information sharing, numerous consistency initiatives and increased coordination among all regulators of state chartered banks. The immediate beneficiary of this effort is currently a small subset of banking organizations. However, seamless interstate and inter-District supervision is a part of a

much broader initiative to instill a risk focus throughout our supervisory process for all banking organizations. Simply stated, adopting a risk focus involves balancing safety and soundness concerns against regulatory burden. That certainly doesn't seem very profound or novel, but we now have better tools to do it and a banking environment conducive to the process.

This takes me to a subject of some interest to me as a Reserve Bank president. I have watched as banks in New England and across the nation weather the problems of the late '80s and take on the challenges of regional, national and global competition and an amazing pace of technological change. In ever more sophisticated fashion, banks small and large have learned to manage the risks they face--both the familiar credit and liquidity risks and the new market, operational, legal and reputational risks. Bank balance sheets and, more importantly, off balance sheet risks can change instantaneously so that senior management must develop process risk control rather than transaction-oriented risk control. For some, risk management may call for modeling

techniques that employ the latest advances in information technology and financial theory -- and a sophisticated risk management system is necessary for such institutions. For others, an adequate risk management infrastructure is based on appropriate internal policies, procedures and limits; and the ability to identify, measure and monitor risks through comprehensive internal controls. But for all, there is the full recognition that risk management is vital.

Reserve Banks, too, have recognized in our own operations the challenges faced by all of you. I spoke about our efforts related to interstate banking. We've also focused on consolidating and streamlining our own operations to provide as cost-effective and responsive level of financial intermediation to our commercial bank customers. Perhaps some of you have seen reductions in our wire transfer and ACH charges, which are a direct reflection of our push toward greater efficiency. However, nowhere is this effort to be more effective or more intense than in our supervisory and regulatory activities. Here we are building on

all your work to perfect risk management within your organizations, and tailoring our efforts as supervisors and regulators to the realities of your institutions. This effort began with what we call risk-focused examinations.

A risk-focused examination process means less time spent on examining specific assets, and more attention directed toward testing the processes that an organization has developed to manage its risks. When we see that a bank has identified risks and addressed them through appropriate internal processes that we have verified through selective transaction testing, there is little to be gained by testing transaction after transaction. With the help of advances in technology, we are able to do more work off-site using information readily available, and to develop customized examinations based on pre-exam risk assessments. When we do come into your institutions, we will have already identified specific areas where more in-depth probing may add value, but you will not be inundated by an army of examiners

running through a one-size-fits-all checklist that may not have any particular relevance for your organization.

We have also been able to carry our risk focus and burden reduction through to the applications process with the help of some much needed legislation in 1996 (The Economic Growth and Regulatory Paperwork Reduction Act) and our own revisions of Regulation Y this year. Those of you whose banks are subsidiaries of holding companies are aware that even the most simple proposal in the past had been subject to unbelievably rigorous review. We are now able to focus on the incremental risk that an organization may face as a result of a proposed acquisition or expansion. That means that well-managed companies can initiate most permissible nonbanking activities without prior review and that the review of banking transactions has been streamlined in terms of scope, information required, and length of processing period. This only makes sense. In our examinations, we are focusing on the processes that shape future performance more than on discrete transactions. If these processes are adequate

there is every reason to think that such institutions are up to the task of addressing a reasonable expansion of activities.

Less burdensome supervision and regulation does not imply more risk tolerance or less concern regarding consumers. The changes made in examinations and applications procedures deal with identifying risk and using resources where they will do the most good. However, by streamlining the applications process so that it no longer serves as a forum for the resolution of extraneous supervisory issues, we have not tuned out consumer concerns. Instead, we are working with community groups to encourage them to maintain a dialogue with credit providers in their markets and to provide input to us. The Federal Reserve Bank of Boston is always available to assist in resolving issues related to banking practices and community needs. Any timely substantive protest filed in connection with an application will also receive due consideration, but we would hope that such actions occur only after good faith efforts have been made on both sides to resolve outstanding issues. As I am sure most of you well realize,

meeting the needs of your communities is only good business; it can and should be profitable if done wisely.

And this brings us back to the type of banking structure we have and why it is important that as it evolves, its strengths are not compromised. The strength of our banking system and our economy go hand-in-hand, and diversity in the number and types of banking organizations lends strength to its structure. The dual banking system and the community banks that are its backbone have provided for flexibility, resiliency and innovation, and choice of charter has improved the supervision of all banks. As new products and services are developed, we in the Federal Reserve System have refined and focused our supervisory and regulatory processes, just as banks have refined the manner in which they manage the risks they choose to assume. Other Federal bank regulators, and state banking overseers, as well, have acted to adapt to the new and more competitive environment. Regulators have "pushed the envelope" of financial structure as well, and

legislative proposals for modernization abound. I welcome this progress.

However, as we pursue modernization, I think we must also seek to preserve what arguably has worked well despite its complex and sometimes cumbersome structure. U.S. bank regulation has, I think, shown itself capable of being flexible, responsive, and supportive of the rather complex banking structure that has served our economy so well, and it is constantly evolving to meet the needs of the banking industry. Moreover, as compared with much of the rest of the world, we've managed to avoid some of the pitfalls other regulatory regimes, and banking structures, have encountered. As we explore ways to enable banking organizations to deploy their resources in other financial service areas such as insurance and securities, and for nonbank financial firms to establish affiliations with banks, we should bear in mind those aspects of our present system that we would do well to preserve.

Thank you.