GLOBAL FINANCIAL CRISES: IMPLICATIONS FOR BANKING AND REGULATION
35TH ANNUAL CONFERENCE ON BANK STRUCTURE AND COMPETITION

Chicago, Illinois
May 7, 1999

Concluding remarks

I. Conference Summary

A. Good afternoon. Before I introduce our luncheon speaker, I'd like to take a few minutes to summarize some of the discussion we've had during this year's Bank Structure Conference.

1. As I said yesterday in my opening comments, global financial crisis is one of the most important topics we've had the opportunity to cover in recent years. How we choose to address this issue in the coming months and years will have lasting implications for the financial industry at large.

2. Following the most recent financial crisis, many observers began openly questioning whether the banking sector is functioning as we think it should. The purpose of banking is to facilitate capital accumulation, and therefore enhance real economic growth. It's therefore somewhat odd, even disturbing, to hear the financial sector accused of bringing the real economy to its knees.

3. In recent years, the talk has not been about the merits of capital market integration across countries. Rather it's been about the dangers of importing financial problems from abroad. And lately we've heard more about the sudden, uncontrollable and damaging price swings associated with free markets, than about the efficient allocation of resources associated with these same markets.

B. I've been very pleased with the degree to which our presenters have avoided this sort of defeatist response. Instead of bemoaning recent industry problems, conference participants have proposed viable solutions to the very real challenges we face.

1. The public policy recommendations presented over the past two days reflected the careful consideration that has been given to the potential impact of these recommendations in the long term.

2. Participants were clearly very cognizant that short-term, superficial responses can inflict long-term, damage to the health of the economy.

3. Having said that, however, there has been scarcely universal agreement on which policies are most appropriate. But I believe the debate in itself has been fruitful.

C. We obviously care about financial crises because they have real adverse effects as Joe Stiglitz said yesterday, the social cost of these crises can be enormous.

1. Even after financial markets recover, unemployment rates may remain high for extended periods of time.

2. There also seems to be a disproportionate impact in less developed countries.

D. Most of the discussion yesterday reinforced the notion that a sound macroeconomic policy is key to avoiding problems in the financial sector, and the associated effects on the real economy.

1. Sound policy and a central bank willing to provide liquidity when needed, go a long way toward heading off crises.

2. In fact, some conference participants went so far as to suggest that perhaps we have become too crises conscious, and have over-responded to recent episodes of market unrest.

3. However, others argued that even good macroeconomic policies don't protect you from global shocks.

E. There was also an emphasis during the conference on the need to rely on market forces to prevent problems whenever possible. Indeed, conference participants generally concurred that a heavy reliance on market forces is the solution to many problems, far more than their cause.

1. Arguments that the market randomly victimizes the innocent typically overlook the role of flawed macroeconomic policy in that victimization. Perhaps even more importantly, such arguments ignore the damage caused by the perverse incentives embedded in the financial regulatory structures of some countries.

2. This is perhaps why many conference participants recommended limiting IMF lending to only those countries with sound banking and financial system regulatory characteristics. Such a move would set the stage for fewer crises and less need for IMF involvement.

F. Another common theme from yesterday's discussion was the inevitability of future changes in the U.S. financial regulatory structure. It was argued that recent crises only serve to emphasize the need for such changes.

1. One speaker, for example, emphasized the need for formally separating the central banking function from the regulatory function; this move would be similar to the approach recently taken in England.

2. Gary Stern from the Minneapolis Fed, noted that while FDICIA and subsequent regulatory reforms were improvements, they are still deficient responses to moral hazard at the nation's largest banks. He argued that the most credible and effective policy response to moral hazard must combine market signals with the best features of existing regulation.

3. Otherwise, those policy responses risk undervaluing the potential of the market to discipline risky firms. Either force alone is most likely inadequate.

G. This conference has also offered us an overview of how market regulation has served the financial services industry historically. The basic conclusion of this brief history lesson? Market regulation has done quite well.

1. One economist argued that over 100 years ago and around the world, a combination of market discipline and limited liquidity assistance through central banks produced a very stable international banking system in developed as well as emerging economies. This occurred, it was argued, in an environment of rigidly fixed exchange rates and much larger capital flows than in today's emerging markets.

2. History, then, argues that a greater reliance on market evaluations of bank risk will not destabilize banking systems. Fears to the contrary it was argued, are simply ill founded.

H. Finally, those of you in attendance at yesterday's session on regulatory reform alternatives heard a debate on a proposition that is receiving so much interest on Capital Hill these days — HR 10, also known as Financial Regulatory Reform.

- You can't get more timely on an issue than we are with this one. Unless the Senate has adjourned for the day, Congress is debating this issue as we speak. These are important issues, and I believe this conference provides an excellent forum for that discussion.

I. Finally, on the issue of financial crises, I think Chairman Greenspan was quite accurate yesterday.

1. He observed that conditions are improving in the Asian countries most effected by recent problems, and productivity increases in the U.S. have allowed it to serve as a buffer against crises abroad.

2. His comments underscored the continuing need to find ways to best manage and even avoid these types of financial crises.

J. As usual, we didn't limit ourselves to the conference theme. We also covered an array of additional topics that have major public policy implications.

1. For example, concerning credit access, one study presented at the conference, using unique mortgage pricing data, found that even in the overage market — one in which consumers are typically uninformed about alternative mortgage suppliers — we still see competition protecting consumers and bidding away most of the overage premium.

2. And yet, despite controlling for a number of factors, the authors found some evidence of differential impact by ethnic group. While they emphasized that it's too early to conclude that this is due to discrimination, it's an area that warrants additional research as we search for means to insure equal access to funding.

K. Concerning the potential for expanded product powers to lead to more stable bank earnings, the results from a study presented this morning challenged the conventional wisdom.

1. Instead of additional powers providing a more stable earnings source, the study found that expanding into fee-based activities makes bank earnings higher, but also more volatile.

2. The results are consistent with a possible risk premium for the fee-based activities.

L. Not surprisingly, the topic of bank mergers has become a recurring issue at this conference.

- What is driving merger activity?

- Is it improved operating performance and cost savings—as typically argued?

- If so, why do industry analysts often have such difficulty finding those savings in the data?

1. One study argued that most of the gains were typically private benefits received through increased CEO compensation.

2. Two other studies argued that the major problem with finding cost savings resulted from the use of accounting data. Mergers often involve restructuring costs which can mask operating gains and which may take a considerable amount of time to be realized.

3. One study adjusted the data for standard merger accounting methods and, unlike previous studies, found evidence that mergers did significantly cut operating costs. In addition, it found that recent mergers achieved greater costsavings than did earlier mergers.

4. An industry analyst argued that there are indeed real gains to be realized in bank mergers, but only in limited circumstances. The greatest potential for gain is with smaller institutions where scale economies and significant managerial efficiency gains can be realized, and with a selected number of acquiring institutions that have successfully built efficient sales cultures.

II. McCoy Introduction

A. Discussions of successful mergers and efficient sales cultures brings me to today's luncheon speaker; John McCoy, President and Chief Executive Officer of Bank One Corporation.

B. As you know, one of last year's major stories in banking was the merger of Bank One and First Chicago NBD, which was completed in October.

1. That created what is now the nation's fifth-largest bank holding company, with assets of more than $250 billion.

2. Bank One is headquartered here in Chicago. It has more than 98,000 employees serving millions of customers.

C. Mr. McCoy is the third generation of his family to be associated with the organization.

1. He joined the company in 1970 after earning a B.A. in history from Williams College and a M.B.A. in finance from Stanford.

2. In 1983, he became Bank One's president and chief operating officer. He was elected president and CEO the following year and became chairman and CEO in 1987.

D. Mr. McCoy is no stranger to the Federal Reserve System, as he served on our Federal Advisory Council in the early 1980s, and was president of the Council for a year.

E. He's also no stranger to this conference, having spoken here before on the benefits of allowing broader geographic expansion in banking. It's a great pleasure to have him back with us again.Please welcome John McCoy.