Conference Summary

We have had some very informative discussions over the past two days, and we have been fortunate to bring together some of the most knowledgeable individuals on the policy issues affecting the financial services sector. As you finish your dessert, and before I introduce our distinguished luncheon speaker, I’d like to take a few minutes to summarize some of that discussion.

In the past at this conference we have evaluated how changes in technology, deregulation, and increased competition have affected the activities of banks and the banking industry. Yesterday Chairman Greenspan discussed how innovations in risk management products have improved liquidity and benefited financial markets. We also had panel discussions of how these changes have altered the lending process.

We have seen banks adapt to recent innovations by focusing more on activities that generate fee income and less on traditional activities that rely on interest margins. Credit evaluation and loan pricing are increasingly based on data from capital markets and credit bureaus rather than banks’ internal store of relationship-based information. Consumer lending has become a high-volume retail business in which margins are tight, marketing and branding are important, and competition is everywhere. These ongoing changes have important implications for the credit creation process and for the macroeconomy.

We heard that traditional bank lending still exists, based on the “soft” information obtained from close borrower-lender relationships that generate not only credit today but also future business activity. This type of lending, however, accounts for a decreasing amount of credit in the economy. Even the community banks that practice these traditional small business lending techniques have had to dramatically alter their approaches in other lines of business.

In the new environment, consumer loans have become much more of a commodity, and the “art of consumer lending” has become a production process. Lenders now rely less on first-hand knowledge about the borrower and more on information that can be drawn from third-party databases. This may enable bankers to extend their reach and
grow more aggressively than before, but it also increases competition from both the banks and other intermediaries that have access to the same information.

Increased competition, coupled with deeper financial markets and new financial products, has also changed the manner in which banks make business loans. Commercial banks compete in credit markets with non-bank institutions like investment banks, insurance companies, and finance companies. Their business customers now have more access to funding directly from the capital and commercial paper markets. In this new competitive environment, the “art of business lending” has gained a high degree of complexity. Loans to large customers trade like securities, banks are increasingly providing risk management in addition to credit, and interest margins are constantly under pressure.

Today banks have access to a broad array of lending techniques, with a relationship focus at one end and a data-focused approach at the other. This is true for both retail lending and business lending. Where on the spectrum banks compete is a conscious choice, but their business models and risk management must be consistent with the choices they make.

Now, bankers are an optimistic bunch, and yesterday's luncheon speaker, Jerry Grundhofer from U.S. Bancorp, made his opinion clear that the banking industry is “better positioned today than ever” to face these challenges. Jerry believes that new analytical tools and sophisticated technologies will allow bankers to meet the need for increased commercial lending despite the challenges brought on by increased competition and macroeconomic uncertainty.

We also heard how the evolution of the lending process has changed the nature of the bank supervisor's job. In the new environment, supervisors must reevaluate decades-old supervisory processes and capital regulations in recognition of methodological and technological advances in the way banks measure and manage risk. For example, the proposed Basel II capital framework will be a major change in the regulation of bank capital. We had somewhat of a warning yesterday concerning the implementation of these new procedures for determining bank capital requirements. The banking industry is currently in good condition and should be capable of transitioning to the new regulatory environment. Nevertheless, it was argued that we need to be careful not to tip the competitive balance between larger and smaller institutions.

This has been a contentious issue within the industry, and previous research in this area has been inconclusive. Yesterday we heard a summary of a number of research studies conducted by the Federal Reserve suggesting that the competitive implications of Basel II capital reforms are actually quite manageable. As expected, the extent to which different loan categories are affected varies somewhat, but it was argued that the agencies should be able to address the competitive impacts of Basel reforms by modifying the existing capital regime before such reforms are implemented. Modifications could include adding more risk buckets for each loan type to make Basel I more risk sensitive.

Finally, this morning we heard a discussion about private pension funds and the Pension Benefit Guarantee Corporation. This has been a topic of particular interest here in Chicago with the recent settlement between United Airlines and the PBGC, shifting to the PBGC certain liabilities associated with United's pension plan. While there was disagreement among the panelists on the exact state of the pension guarantee fund, the description of the situation served as a wakeup call.

It brought back memories of another guarantee fund often discussed at this conference during the 1980s. In fact, more than one panelist mentioned the parallels between the PBGC and the FSLIC, the old and now defunct guarantor of deposits at savings and loan associations. The parallels included criticism of accounting procedures and a
seeming lack of concern by those in Washington to recognize and act on the problems. I encourage researchers at this conference to keep abreast of this situation and help provide the means to address these difficult issues.

The discussion of private pension plans led us naturally into a lively debate about the viability of the U.S. Social Security system. There are two fundamental issues currently being debated. First, is the Social Security system on a firm financial basis, and if not, how can we best address this problem? The answer is: it depends. The current administration believes that, if changes are not made, the future solvency of the system will be in danger. Congressman Oxley stated that the pay-as-you-go structure of the system, combined with continuing demographic trends, drives the current need for reform. We also heard an alternative perspective this morning arguing that the problems associated with Social Security have been overstated as a result of overly pessimistic projections of future productivity growth and immigration trends. Depending on the projection used, either sweeping changes or only relatively minor adjustments are necessary to ensure Social Security's future viability.

The second major debate surrounding Social Security concerns the proposed use of personal accounts to allow individuals to take more of an ownership role in managing their savings. It was argued that the current system is a bad deal for future retirees as a result of low returns, lack of flexibility, and an inability to take advantage of the benefits of diversification. The opposing argument is that the move toward personal accounts loses sight of the purpose of Social Security, which—as an insurance system—is supposed to redistribute funds across income groups and among those with different life spans.

In summary, I believe that once again the conference has succeeded in bringing together relevant parties from within the industry, the regulatory agencies, and academia to provide critical input and help shape public policy. I appreciate the advancement of the debate by both program participants and experts from the audience. This format has allowed us to discuss some of the more contentious policy issues affecting the financial services industry. And, of course, we're not finished yet.

This afternoon, we have concluding concurrent sessions on Intervention in Loan Markets and Addressing Credit Needs.

But first, it is my pleasure to introduce today's luncheon speaker, Julie Williams. Ms. Williams is the Acting Comptroller of the Currency and the Chief Counsel of the OCC. Julie joined the OCC in 1993 as Deputy Chief Counsel. Prior to the OCC, she served in a variety of positions at the Office of Thrift Supervision and its predecessor, the Federal Home Loan Bank Board.

Now, as Chief Counsel, she is responsible for all of the agency's legal activities, including legal advisory services, enforcement and compliance activities, litigation, legislative initiatives, and regulation of securities and corporate practices of national banks. She also currently leads the OCC Executive Committee in providing policy and strategic direction to the agency.

Regarding her status as Acting Comptroller, Julie told the American Banker in an interview last fall that “Acting comptrollers act”—she's not just there to keep the seat warm, but she's there to take on the tough issues and do all that the job entails. Since we have a tradition here at this conference of bringing in the Comptroller of the Currency as a featured speaker, she's now here to do her job, and for that we are most grateful.