

Challenges Of The 90s

After-dinner Remarks

by

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Comptroller Clarke, Director Martoche, Governor LaWare, ladies and gentlemen. It is a great pleasure to be with you tonight to participate in this conference that has the very important goal of enhancing coordination and cooperation among the federal supervisors of depository institutions. Given the many financial problems of the day and the growing integration of financial markets in this country and throughout the world, it is now more important than ever for us to hold meetings such as this to exchange views on matters of common interest and to promote cooperation and goodwill in the discharge of our common responsibilities.

#### A Look Back At the 1980s

I intend tonight to discuss the challenges our agencies will be facing in the coming decade and what we need to do to address them. As prologue, however, it seems well to begin by briefly looking back to the truly remarkable decade that just ended.

Had we met here in this setting at the start of that decade, I doubt that any of us would have forecast the breadth and dimensions of the problems that were to unfold in the depository system. And, had we suspected the severity of the problems in store, I feel equally sure that most of us would have had grave doubts about the ability of the depository and financial system to avoid a serious systemic crisis with consequent effects on the economic system.

All who are here this evening are, of course, intimately aware of the developments and events that came to pass over the period. I thus need to cite but a few salient facts to characterize the period. Commercial bank failures over the decade cumulated to more than 1,000 involving assets totaling more than \$88 billion, figures not seen since the great depression. A number of other banks, large and small, received FDIC open bank assistance, and yet many others barely escaped falling into one of those two categories. And, still, at the end of the decade, there remained more than 1,100 banks with serious problems. For the most part the resolution of problem situations was accomplished by the banking agencies working in close cooperation. Most particularly, the Federal Deposit Insurance Fund successfully and ably weathered this storm, although it was seriously tested, as evidenced by the decline to an historically low level of its reserves to deposits ratio.

The thrift industry, of course, fared much worse. A huge proportion of the industry's institutions either failed or were placed in conservatorship, and many others are destined soon to move to that status. Indeed, the dimension of the industry's problems proved so large that its insurance fund was overwhelmed, with a huge volume of losses left to be covered from other funding sources, mainly the general taxpayer.

Vast misallocations of real resources resulted from the bank and thrift problems just reviewed. In some cases, excessive compensation to insiders financed lavish life styles, improper and inept lending led to a plethora of empty or near-empty

buildings in all too many cities of our country, and a host of other questionable lending policies and practices resulted, or have the potential of resulting, in other wastes and inefficiencies. A good deal of fraud was committed. Public respect for those in the banking and financial area has suffered.

But, while many negative aspects can be cited, the decade also had many important positive aspects as well. Most importantly, despite the many problem situations, which sometimes came in bunches and affected both large and small depository institutions in various sectors of the country, a systemic crisis in the depository system was avoided. And, because the safety net worked, the nation's economy was able to enjoy a record period of growth. The safety net (deposit insurance and the availability of the discount window) has come in for considerable criticism in recent years because of the dampening effect it tends to have on the impact of market forces in disciplining depository institutions. While those criticisms may be well founded, it behooves us all not to forget the very critical role the safety net played in promoting financial stability.

Over the decade great strides were also made in addressing many specific problems in the depository system. LDC debt exposure, which posed a particularly serious threat to our major banking organizations at the start of the decade, was brought into more manageable proportions through the combined efforts of the lending banks, the borrowing countries, the U.S.

government, including bank regulatory authorities and international agencies. And many other credit problem areas encountered early in the decade had by its end lost most of their potential for harm -- one thinks in particular of such troubled areas as farm loans, energy loans and shipping loans.

There is a further point that deserves mention in this short review. It is that, in general, the supervisory/regulatory capabilities of the agencies assembled here this evening are stronger today than they were at the start of the decade. The OTS is entering the 90's with a well-staffed cadre of trained supervisory personnel and effective systems and operational procedures in place. The resources of the banking agencies have been bolstered over the decade and they have conducted thorough reviews of their policies, practices and operations. Supervisory standards, regulations and guidelines have been strengthened and operating procedures tightened, with initiatives taken in the area of strengthening and refining capital standards perhaps most deserving of special notice.

A further achievement is that despite the wide range of problems in the banking and thrift sectors and the adverse publicity attending thereto, the public's confidence in federal deposit insurance and in the depository system itself has been maintained. Given the dimensions of the difficulties of the 1980s, that is no small accomplishment, indeed.

### The Challenges of the 1990s

There is an ancient Chinese "blessing" that says: "may you live in interesting times." Having just passed through the 80's, I feel sure that all here assembled would be inclined to pray not to be so blessed in the 90's. However, I think we would all also recognize that this is one of those cases in which a prayer is likely to go unanswered.

Consider the many challenges and problems that we already know lie before us. While, as I have noted, some success has been achieved in working down the number of problem banks, the level still stands at over 1,100, a quantum difference from that which existed at this time ten years ago. And, of course, the dimensions of problem situations in the thrift sector are even more serious.

Looked at from a slightly different perspective, while we have made some measured progress in working through the difficulties of depository organizations in the southwest, there remains a long way to go before conditions can be said to have returned to normal. The overhang of properties and troubled institutions alone will serve to prolong and complicate any restoration. And, in the last couple of years, problems of considerable severity have surfaced at institutions in other areas of the country, especially New England.

The continued heavy exposure to LDC debt of our multinational banks, also remains a concern as does the exposure that many banks have to highly leveraged borrowers. And, of

course, the risks associated with any or all of these areas of concern would greatly compound, if the general economy were to slide into a recession, a development we have most fortunately avoided for a number of years.

The fundamental general forces of change at work in the financial system will also present their own special challenges. The movement toward nationwide banking that has been gaining momentum, the parallel globalization process of the world's financial markets, the technological advances and financial innovations that continue to come forth rapidly will all serve to maintain intense competitive conditions for depository institutions. And these same conditions will also serve to increase the riskiness of the environment in which institutions must operate. The special provisions of FIRREA as they apply to thrifts add yet another dimension of challenge to organizations seeking to operate in a profitable but safe and sound way.

What can our agencies do to meet these challenges? For one thing we must explore ways to modify the deposit insurance system and supervisory process -- for example, perhaps by developing early closure procedures -- so that the forces of market discipline have a more effective influence on the activities of banking organizations. Concerted efforts along these lines are, of course, already underway with the deposit insurance study that all our agencies are participating in under the general direction of the Treasury Department.

There is also a need for us to continue seeking ways to expand the powers open to banking organizations so they are

better able to compete in the fast changing, highly competitive financial environment of the day. From discussions I have had with my counterparts in other agencies, I believe there is a broad consensus among us as to the nature and extent of the powers that should be accorded banking organizations. That common agreement, I believe, to be very salutary. That we lack the same consensus on organizational arrangements best suited to introduce those powers, on the other hand, is an unsettling fact best left for discussion at a less collegial gathering than this one tonight.

There is also a need for our agencies to continue to review and improve our existing regulations, guidelines and operating practices. And, here, too, there are a range of initiatives underway, including those aimed at incorporating measures for interest rate risk and foreign exchange risk in the recently adopted capital standards. There are also many other initiatives under consideration, as a review of the agenda of this conference will clearly attest.

We must also sustain our efforts on the personnel front. In the last few years we have all brought our compensation packages into better alignment with those available in the private market, and this has and will help us to attract and retain qualified supervisory personnel. It is imperative as we proceed to vigilantly guard against the temptation brought on by tight budgetary considerations of letting that improved competitive stance be eroded by persistent piecemeal cutbacks.



Lastly, our individual agencies must continue to work together in addressing common problems and achieving common goals. While one hears talk about yet another study of ways that agency responsibilities might be better consolidated and structural overlaps eliminated, if the past is any guide, the organizational framework and assignments of responsibilities are likely to remain pretty much as they have in the past. If we are to meet the challenges of the 1990s, our past commitment to cooperation and coordination needs to be redoubled.

Those then are the challenges that are facing us and the steps we must take to address them. The task before us will be a difficult one, and, as in the past, the work burden required, a heavy one. Given the importance of the mission, that is a burden I am sure we are all willing to assume and working cooperatively, one that we can successfully accomplish.