Remarks by
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Money knows no boundaries, and therefore bank supervisors around the world face common problems and common issues, which in turn call on us to take common approaches to international supervision over a range of institutions and national regulatory issues. With the elimination of distance brought about by telecommunications and computer technology, the safety and soundness of our financial institutions rests on cooperation and coordination among international supervisors. Certainly the failure -- two years ago last week -- of Baring Brothers and Company, then the oldest merchant bank in London, brought down -- half the world away -- by a 27-year-old securities trader with a computer, reminded all of us how technology has made globalization a fact. This globalization makes it in all our best interests for national authorities to cooperate and coordinate banking supervision around the world.

Our common interests and common issues also imply that we can learn from each other -- the experience of one holds meaning for all.

Bank supervisors everywhere face the same difficult question: How are we to recognize problems early so that we can address them before they irreparably damage institutions, strain the safety nets that we have created for banking systems, and threaten the stability of those systems and of the economies they serve? In addressing that question, we must steer a balanced course between the theoretical extreme where there are no problems and the extreme where everything is a problem. In other words, we must steer the course that is justified by contemporary facts. This balanced course recognizes that when things are going badly, the pendulum has a way of swinging back -- and when things are going well, the pendulum may swing the other way.

This balanced course is charted through critical analysis and sound judgment -- it requires us regulators to be skeptical of conventional wisdom and never to be wholly optimistic or pessimistic. To steer a balanced course, we must develop our expertise and expand our knowledge by benchmarking where banking is now -- and where it has been previously -- to give us a better perspective of where it could be going in the future and where we should focus our attention.

I am here today to talk about some of the efforts that we at the Federal Deposit Insurance Corporation are making to learn from the lessons of the past so that we can find answers to the question of how to recognize problems early. Our experience over the past 20 years has made the search for the answers all the more pressing. We hope that others can learn from that experience.

When I became Chairman of the FDIC in late 1994, I initiated a study of the lessons of the 1980s and early 1990s, when the United States experienced a prolonged banking and thrift institution crisis. This project is now nearing completion. During 1997, we plan to publish 14 papers detailing our findings. Last month, the first papers from the project were presented at a symposium we sponsored.

From the beginning of this project, it seemed obvious that the past holds lessons for the future. This is true not so much because history might repeat itself -- which I consider unlikely -- but rather in the sense of whether we can learn broader lessons that may help us mitigate future problems.

From the beginning of 1980 through 1994, 1,617 banks insured by the FDIC were closed or received our financial assistance. That number -- 1,617 -- constituted nine percent of all the banks in this country. Their assets totaled more than $316 billion. To put that total in perspective, it is more than seven percent of the assets of FDIC-insured commercial banks today. In looking back at these failures, one pattern was extremely clear -- credit problems of U.S. banks in the 1980s and early 1990s were generally preceded by waves of rapid growth and speculation in lending -- lending to the agricultural, energy, and commercial real estate sectors, as well as lending to sovereign borrowers. Banks that were aggressive lenders in a boom period with little regard for credit quality suffered when a bust followed.

Fueled by export growth and rising commodity prices, U.S. agriculture in the 1970s enjoyed a boom. Banks began to make loans to agricultural producers that were secured by the inflated values of farm land. When the boom ended in the early 1980s as farm prices turned down, land values declined and cash flow was insufficient to repay the debt. Agricultural lenders experienced large loan losses -- and agricultural banks accounted for more than a third of bank failures from 1984 through 1987.

Substitute the words "oil boom" for "agricultural boom" and you have a similar story. Strong worldwide demand for oil and restrictions on supply created by the Organization of Petroleum Exporting Countries brought on a sharp rise in oil prices and rapid economic expansion in the Southwestern United States.

The weakening of oil prices after 1981 and the sharp collapse in 1985 -- brought on chiefly by recession in oil-consuming nations and the collapse of the international oil cartel -- resulted in the first of two sharp economic downturns in the Southwest during the 1980s.

The real estate "boom" came during this period, too. Commercial bank real estate loans more than tripled over the decade of the 1980s, while commercial loans nearly quadrupled. These increases were accompanied by a pervasive relaxation in underwriting standards for construction and commercial real estate. Borrowers frequently had no equity at stake and all of the risks were borne by lenders.

As many of the people in this room remember only too well, in August 1982, Mexico announced that it would be unable to meet its principal payments to foreign creditors. Thereafter, Brazil, Argentina, and many other borrowing countries followed suit. This came after the banks were actively encouraged by some policymakers in the 1970s to recycle petrodollars. The banks unfortunately concluded that the fastest way to lend dollars was through balance of payments financing without any clear source of repayment -- and with too much faith in optimistic expectations about the economic and financial prospects of many developing countries. By 1982, the non-trade exposure of the average U.S. money-center bank to non-OPEC developing countries was 227 percent of equity capital and reserves. The problem went well beyond the borders of this country to the major banks of other developed countries.

One feature that all of the borrowers in these various credit crises shared was the widespread belief in the unlimited potential of their economic interests, and lenders came to share that perspective. Sometimes government officials and so-called experts did, too. In the 1970s, two U.S. Secretaries of Agriculture told American farmers that demand would absorb whatever they could supply. Some analysts predicted in the 1980s that the price of petroleum would rise as high as $100 a barrel. One prominent banker said countries might run into liquidity problems but would never default. As late as 1990 and 1991, some economists were discounting the prospect of a real-estate bust in California.

All of this, of course, is an old story. Why am I telling it? Because memories can be short and because we can draw several enduring lessons from our experience.

One is that inflated expectations provided a false sense of security.

A second is that in each case we thought the crisis of the moment was unique and there was a tendency not to draw from each experience the broader implications. We did not notice until it was too late the warning signs of inflated expectations, rapid growth, speculative activity, weak capital, and credit concentrations. By the time most of us working on these issues realized that the individual crises were linked by common forces that were pushing financial institutions to exploit new areas of lending beyond sustainable levels, the problems had become cumulative.

A third lesson was that banking authorities needed a means to take greater account of economic data in bank examinations and supervision, and to monitor trends in the industry and the economy for warning signs.

Neither we nor the industry we supervise can afford to be as wrong as we were in the 1980s again. To avoid being that wrong again, we need a means to monitor trends more broadly and to take specific action on the information we receive.

To that end, at the FDIC we have begun to include current economic and financial data more broadly in the examination and supervision process. More than a year ago, I created the Division of Insurance to analyze these and other data so that we can stay on top of emerging trends and alert the banking industry to new and existing risks more effectively. Such notices can be purely economic -- such as analyses of recessions of the kind that rolled across the United States in the 1980s and the 1990s.

These notices may also discuss the effects of other types of events on financial institutions -- such as legislation. Early and thorough analysis of rapid interest rate deregulation and the sudden shift in the real estate investment climate brought about by the Tax Reform Act of 1986 might have alerted lawmakers to the need to give banks time to react to changing statutory requirements and incentives.

Our analysts also provide and use economic and other data to help examiners assess the risks to which individual banks are exposed and they analyze international, national and regional economic trends that can affect individual institutions. These analyses can help us take a balanced approach to bank supervision where our actions are justified by current realities.

Our Division of Insurance is producing quarterly reports on developments in each of the eight supervisory regions of the FDIC, and we will soon make these reports public.

One example of our efforts to identify particular problem areas dates from last June when we highlighted problems in consumer credit card lending at banks. Lines of credit offered by commercial banks through credit cards, including loans outstanding and unused commitments, had more than doubled in the previous four years. Credit card loans held by commercial banks had increased by 56 percent. As we learned in the 1980s, rapid loan growth is a red flag. Losses on credit card loans were also growing rapidly -- to $2.2 billion in the first quarter of 1996 -- up from $1.35 billion in the first quarter of 1995. Net charge-off rates neared the peak of 4.97 percent experienced in the aftermath of the 1990-91 recession. In addition, we were the first agency to make the connection between rising personal bankruptcies and higher credit card loan charge-offs.

While these credit problems do not signal a return to the banking crisis of the 1980s, they can be addressed before they become more significant. We want banks to give attention to small problems before they become large problems that can cause losses to the deposit insurance funds. There are signs that banks with significant credit card lending are taking steps to help mitigate exposure to an economic downturn.

There have been reports that banks have tightened underwriting standards on credit cards, and the volume of credit card mail solicitations apparently has slowed. According to a company that tracks credit card activity, mail solicitations were down almost 11 percent in 1996 from 1995, the first decrease in annual credit card mailings since 1991.

More recently, we have been closely watching trends in syndicated lending, also a rapidly growing area. In 1993, syndicated loans totaled $389 billion. In 1996, they totaled $888 billion -- more than doubling in just three years. In light of this dramatic growth, analysts and market participants have raised concerns about narrowing interest rate spreads and relaxation of underwriting terms. For example, for the best non-investment quality loans, the spread over LIBOR has declined from approximately 120 basis points in June of 1993 to approximately 70 basis points currently. Are lenders being adequately compensated for risk or -- as was the case in the 1980s -- do narrowing spreads suggest a lack of differentiation for different degrees of risk?

Foreign banks purchased more than half of the total syndicated loans originated last year, according to the Office of the Comptroller of the Currency, and smaller commercial banks outside the money market centers -- the kinds of banks the FDIC regulates -- purchased 17 percent of them.

There has been some anecdotal evidence that downstream lenders have become more willing to accept these loans without receiving full documentation or making independent credit analyses -- a disturbing sign that memories are short.

The question I want to raise is whether syndicated loans at narrower spreads and under relaxed terms can be justified if we should experience a harsher economic climate?

While it appears that syndicated lending has yet to result in major problems, and while the economy and corporate earnings remain strong, bankers still cannot afford to be complacent. No one has repealed the business cycle.

I am not suggesting that we are returning to the 1980s, but our experiences then should have taught us -- along with the need to be alert to warning signs such as rapid growth and fewer credit distinctions -- that we must take into account the potential effect of an economic downturn in assessing risks.

I urge bankers to look closely at their businesses to determine whether they are receiving a return adequate for the risks they are taking, if the economies in which they operate -- especially regional and local economies -- should weaken.

Experience gives us the basis of fact that allows us to take a balanced approach to bank supervision. More broadly, we can learn from our differing experiences in other ways as well. The Basle Committee on Banking Supervision is currently pooling the expertise and knowledge of its 12 member-countries to develop a set of universal minimum standards for sound bank supervision -- principles that are fundamental to an effective bank supervisory system in any country, anywhere in the world. These standards are being developed in concert with regulators from other developed and developing countries. The subjects of these standards range from accounting to risk management to corporate governance.

Because bank supervisors face the same challenges everywhere, the importance of having common minimum standards cannot be overstated. Such standards will give us a foundation on which to develop solutions to common problems in the globalized economy in which we all function. Common standards will allow us to provide balanced bank supervision -- across national boundaries -- that would protect the public from harm, while allowing financial institutions the maximum freedom to perform their functions. Without sound bank regulation to undergird their financial systems, some countries -- particularly newly democratic countries -- will not enjoy the level of foreign investment that they may need for sustained economic growth.

Ultimately, the purpose of balanced bank supervision is to create a climate in which everyone -- banks and bank customers alike -- feels secure. These minimum standards will significantly contribute to creating a safer global banking marketplace that is better for the international economy, your institutions, and the customers you serve.

Thank you.

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