Reflections on the History of Banking Conferences at the Chicago Fed

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FEDERAL RESERVE BANK OF CHICAGO
The views expressed today are my own and not necessarily those of the Federal Reserve System or the FOMC.

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Introduction

Thank you, President Reed, for your kind introduction.[1] And thank you, Doug Evanoff, for inviting me to speak at the opening of Loyola University's Kaufman Center for Financial Policy Studies, named in honor of George Kaufman.[2] I am especially pleased to kick off the center and today's conference, not least of which because I worked alongside Doug for over 25 years. Doug helped the Federal Reserve Bank of Chicago achieve its policy goals as well as make it a top research organization. I know he will bring the skills he developed at the Chicago Fed to his new job as director of the Kaufman Center.

Before I begin, I should note that the views I share with you today are my own and do not necessarily represent those of my colleagues on the Federal Open Market Committee (FOMC) or others in the Federal Reserve System.

Let me start with a few words about George Kaufman. George spent most of his career in Chicago—which began when he joined the Chicago Fed straight out of graduate school in 1959. After about a decade working at the Bank, George spent time on the East and West Coasts before deciding that Chicago is where he belonged: He took a

[1] Mark C. Reed is the president of Loyola University Chicago.
[2] Douglas D. Evanoff is the director of the George G. Kaufman Center for Financial Policy Studies, Quinlan School of Business, Loyola University Chicago. More information about the center is available online, https://www.luc.edu/quinlan/about/leadershipcenterslabs/finpol/.

job here at Loyola University, where he remained for the rest of his lengthy career. After returning to the area, he quickly reconnected with the Chicago Fed.

George had a deep and long-lasting connection to the Federal Reserve, which began when the institution wasn't yet 50 years old. To give you an idea of that connection, when the Fed celebrated its centennial in 2013, George was invited to serve on the System's centennial committee along with past Federal Reserve Chairs Paul Volker and Alan Greenspan, as well as other financial regulatory leaders.

Creating the Bank Structure and International Banking Conferences

Among his many contributions, George played a central role in creating the Bank Structure Conference[3] and the International Banking Conference,[4] two long-running conference series organized by the Chicago Fed.

The inaugural Bank Structure Conference, which many considered the preeminent banking forum, was held in 1963. This conference was held regularly for over 50 years. George was likely the only person who attended both the first and last Bank Structure Conferences.[5]

As an economist, the director of research, and later president of the Chicago Fed, I made it a point to attend these conferences. As some of you no doubt remember, there was a strong group of regular attendees, including George, George Bentson, Ed Kane,

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[3] Details on the Bank Structure Conference series are available online, https://www.chicagofed.org/events/bsc-series.

[4] Details on the International Banking Conference series are available online, https://www.chicagofed.org/events/international-series.

[5] The Bank Structure Conference was created as a result of a U.S. Supreme Court case that required bank regulatory agencies find the most effective means of analyzing the antitrust implications of bank mergers. George immediately gathered the most knowledgeable people in the Federal Reserve System to debate the alternatives.

and a number of younger scholars. The mix produced many interesting discussions that had a lasting impact.

The Bank Structure Conference that George was instrumental in founding quickly established a strong reputation. And as the global financial system became more interconnected, George—along with Curt Hunter, who was my predecessor as research director at the Bank—saw a need to supplement the generally more U.S.-focused conference with one having a more international emphasis. In 1997 they, along with Doug Evanoff, organized the Chicago Fed's first International Banking Conference. This conference continued to draw thought leaders from around the world through 2016.

These two conferences brought together policymakers, academics, and industry representatives to discuss important changes in the banking environment, to debate future risks, and to anticipate promising opportunities. One of the highlights of the Bank Structure Conference was the appearance of the Chair of the Board of Governors of the Federal Reserve System. While Chair, Ben Bernanke spoke at six conferences and Alan Greenspan spoke a remarkable 16 times.

George realized the advantages of bringing together the best research minds to discuss and debate the issues. Not surprisingly, that is also the goal of this center—and this conference.

Conference themes

Both conferences had a penchant for anticipating challenges. For example, the focus of the 1997 International Banking Conference was how to prevent banking crises. The conference was held in June, mere weeks before the Asian financial crisis began. Later,

in the years before the Great Financial Crisis, the role of large banks in systemic financial risks was examined again in 2004—when the conference theme was Systemic Financial Crises: Resolving Large Bank Insolvencies—and in 2007—when the theme was Globalization and Systemic Risk.

Similarly, presentations at Bank Structure Conferences anticipated regulatory reforms in banking, with most proposed changes discussed at the conferences for many years before any actions were implemented.[6] The topic of changes in bank capital regulation comes to mind, and I see that it is again on today's program. Years before imposing a formal set of minimum capital requirements in the 1980s, their potential adoption was the focus of the 1975 conference. There is a long list of banking laws, with elements vigorously debated at the conferences both before and after their passage—FDICIA, Riegle–Neal, Gramm–Leach–Bliley, and FIRREA are among them.[7]

This is a good time to point out the central role George played in many of these debates. George was a leader in thinking about the importance of bank capital. He understood that banks had an incentive to take on more risk as they became weaker and approached insolvency. He pressed regulators to require banks to hold more capital as they weakened and, additionally, to increase their supervisory oversight. Through George's efforts, both of these regulatory enhancements were incorporated in the Federal Deposit Insurance Corporation Improvement Act.

[6] This observation is from Evanoff et al. (2008).

[7] FDICIA stands for the Federal Deposit Insurance Corporation Improvement Act of 1991. Riegle–Neal is shorthand for the Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994. Gramm–Leach–Bliley is shorthand for the Gramm–Leach–Bliley Act (also known as the Financial Services Modernization Act) of 1999. Finally, FIRREA stands for the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.

Discussion of research presented at the conferences

Those earlier conferences inspired and produced much cutting-edge research. Doug Evanoff, along with several co-authors including Bob DeYoung, who's in the audience today, examined over 600 research papers that were presented at the first 40 or so Bank Structure Conferences. Impressively, over three-quarters of them were later published—many in the top economics and finance journals.[8] One-hundred and two were in what we call A-level journals, such as the *Journal of Finance* and the *American Economic Review*, with another 155 accepted by journals most academics would be very happy with. Some of these articles were quite influential in the academic literature and in the development of public policy. They spurred vigorous debate and produced a more nuanced understanding of the financial sector. Let me highlight a few of the contributions.

George correctly argued that banks with low capital have an incentive to take additional risk. However, there is also a countervailing force that was first pointed out by Michael Keeley of the San Francisco Fed in a paper he presented at the Bank Structure Conference in 1989.[9] Keeley argued that the "charter value" of banks—that is, banks' ability to earn profits in the future—reduces the incentives for banks to take risk. A bank that has market power—and thus the ability to profit in the future—may refrain from gambling even if it currently has low capital. His influential paper gave policymakers and academics a novel way to think about bank competition, which continues to this day.

[8] Evanoff et al. (2008).

[9] This paper was later published as Keeley (1990).

Another important debate aired at the Bank Structure Conferences involved the question of what activities banks should be permitted to engage in. The banking crisis at the start of the Great Depression prompted Congress to pass the Glass–Steagall Act, which in part was designed to separate the banking business into two separate functions: Commercial banks would accept deposits and make loans, while investment banks would bring debt and equity issues to market and trade securities and other instruments. This distinction held for several decades; however, as early as the 1960s, both commercial and investment banks began to encroach on each other's turf. This sparked a debate about whether the Glass–Steagall Act was necessary. Randy Kroszner and Raghu Rajan, both of the University of Chicago, presented an influential piece of research at the Bank Structure Conference in 1992. It was eventually published as "Is the Glass–Steagall Act justified? A study of the U.S. experience with universal banking before 1933."[10] In it, the authors argued persuasively that the fears that banks would have a conflict of interest when bringing to market securities of firms they had lent to were not well founded. Their influential paper helped support the repeal of the Glass–Steagall Act that happened as a part of the Gramm–Leach–Bliley Act.

The Bank Structure Conference was also a forum to present research on whether and how banks are special—a topic that continues to be discussed today. In the early 1990s, Allen Berger and Greg Udell presented their work on relationship lending and the role of lines of credit in financing small firms. Their notable paper later appeared in the *Journal of Business*.[11] Allen and Greg, both of whom are here, pointed out one way

[10] Kroszner and Rajan (1994).

[11] Berger and Udell (1995).

that banks can be considered special: They argued that banks learn about their customers and develop long-term relationships with borrowers that affect both the interest rates and collateral required on loans. This afternoon Allen will present his latest work with Arnoud Boot of the University of Amsterdam on bank specialness.

Banks didn't seem so special—at least in a good way—in the aftermath of the Great Financial Crisis. Both the Bank Structure Conference and the International Banking Conference had a number of memorable presentations on risks and what to do in response to the Great Financial Crisis. We heard from Anat Admati of Stanford University about her work with colleagues arguing that banks be required to hold more capital to mitigate financial instability risks. This, as you can imagine, wasn't very popular with the bankers in the audience. We also heard from Rob Engle of New York University, who with his co-author Christian Brownlees developed a measure of systemic risk. In a notable presentation, recent Nobel Prize winner Douglas Diamond discussed the consequences of liquidity risk.[12]

The Bank Structure and International Banking Conferences that George advanced were important forums for high-quality academic researchers to inform and learn from policymakers and industry professionals. While we've made a lot of progress since the first Bank Structure Conference in 1963, some of the same issues remain—and we have a host of new ones. Later today, you'll hear about bank capital regulation—a perennial issue—as well as bank uniqueness and how bank regulators should think

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[12] The published versions of these papers are Admati et al. (2014), Brownlees and Engle (2017), and Diamond and Kashyap (2016). Some of Diamond's earlier work on liquidity—eventually published as Diamond and Rajan (2005)—was initially presented by his co-author at one of the conferences.

about social goals. The sessions on these topics promise to provide insightful and stimulating discussions.

Concluding remarks

The Kaufman Center and this conference are meaningful extensions of George's drive to create an ongoing forum for expert discussion. Among other objectives, the center aims to bring together nationally recognized experts in banking and financial services, students, the banking community, and the general public to inform policy debates and stimulate important research.

The center's focus on topics that George Kaufman was passionate about is a fitting tribute to George's memory and legacy. I anticipate hearing about the Kaufman Center and its impact on policy for years to come.

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