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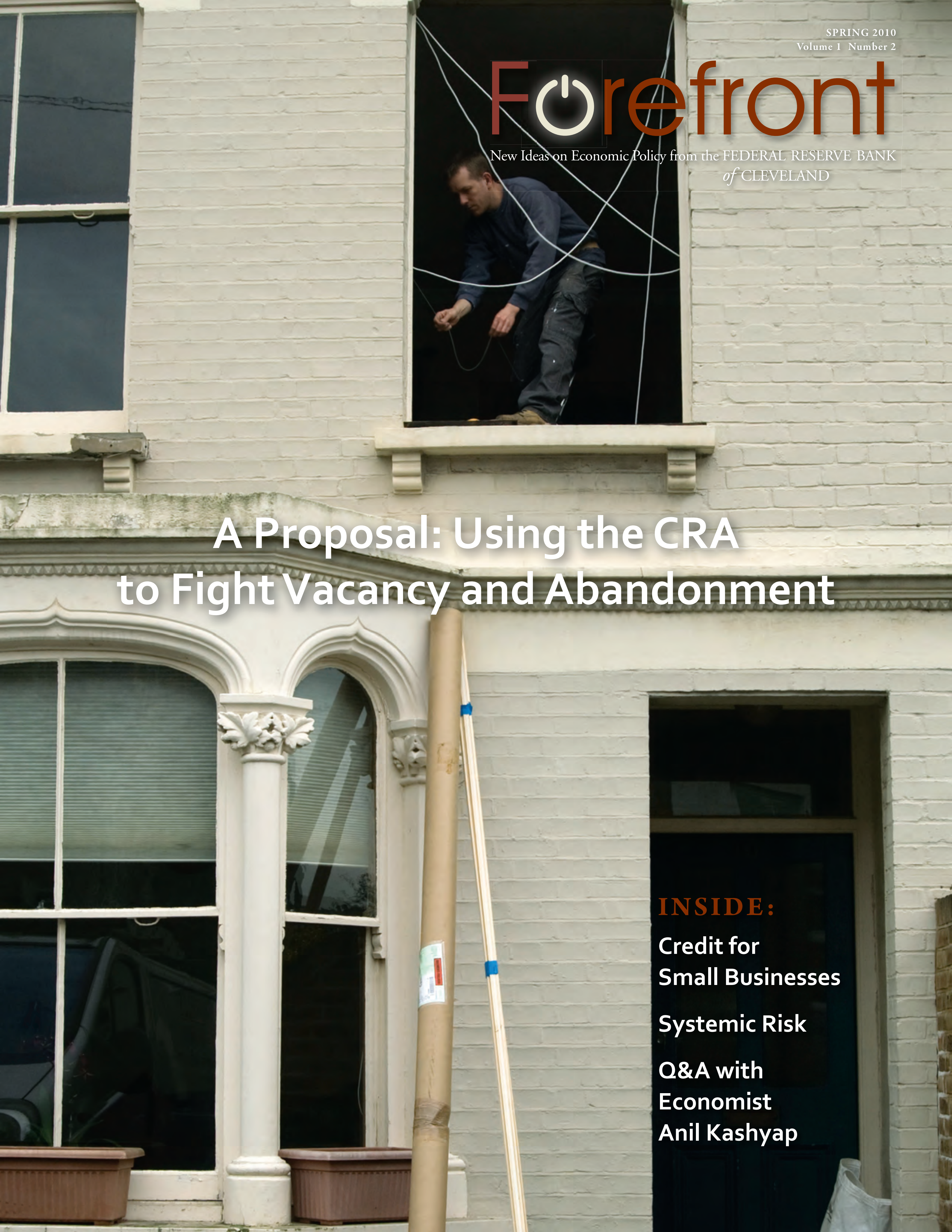
Forefront

New Ideas on Economic Policy from the FEDERAL RESERVE BANK *of* CLEVELAND



A Proposal: Using the CRA to Fight Vacancy and Abandonment

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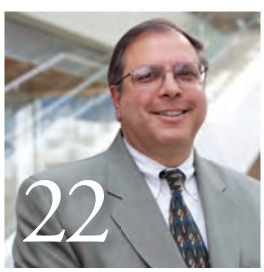

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PRESIDENT'S MESSAGE

Sandra Pianalto
President and Chief Executive Officer
Federal Reserve Bank of Cleveland

Some say that major reforms can be enacted only after a major crisis occurs—after conditions become "bad enough." History and human nature clearly confirm this view. What is less obvious is that hasty reactions following a crisis do not always solve the problem—in fact, they can often create new problems. If reforms are to be successful and enduring, they should reflect comprehensive assessments and analyses of the factors that contributed to the crises.

I think it's absolutely true that "you cannot reform what you don't understand." In the wake of the recent financial crisis, there is much more that we ***do*** understand—lessons built on the front-line experiences we at the Federal Reserve Bank of Cleveland have lived through as banking supervisors.

Through the thick of the crisis in 2008 and early 2009, our direct involvement in the supervision of banking organizations in the Fourth Federal Reserve District, and our knowledge of supervisory activities throughout the country, exposed gaps in the supervision of the financial sector that contributed to the crisis. Since then, we have been able to step back and examine the conditions that existed during those dark days and evaluate the circumstances behind them.

Our experiences during the crisis reinforce the view that the Federal Reserve should continue to supervise banking organizations of ***all*** sizes and should take on an expanded role in supervising systemically important financial institutions. Retaining our role in the supervision of banks of all sizes is vital.

Our nation's banks serve an extremely diverse range of customers, industries, and geographies. Their health is critically important to the communities and regions they serve. During the peak periods of strains in financial markets, these institutions looked to their Federal Reserve Banks for liquidity. As banking supervisors, we had a firsthand understanding of the safety and soundness issues facing banking companies. This information was critical to us in our role as lender of last resort, as we understood the particular liquidity circumstances they faced. And as the central bank, we recognized the risks to the economy of credit markets seizing up. Our experience enabled us to respond quickly. We adapted our regular discount lending programs to create an auction facility, and we provided for longer lending terms and more collateral flexibility—not just for the largest and most complex banking organizations, but for ***all*** banking organizations.

In my Reserve Bank, the economists worked closely with banking supervisors and discount window lenders to pool information, assess situations, and make decisions. And I can tell you that the knowledge, expertise, and direct access to information that come from our supervision and lending responsibilities contributed to our effectiveness in monetary policy. Even today, the intelligence I gather from my banking supervisors is extraordinarily useful to me as a monetary policymaker in helping to identify factors that may pose risks to my economic outlook.

This collaboration extends beyond monetary policy, too. In this issue of *Forefront*, we highlight how our economists are working with bank examiners to tackle access to credit for small businesses. These examples support my view that no other agency has, or could easily develop, the degree and nature of expertise that the Federal Reserve brings to the supervision of banking organizations of all sizes.

Financial reform is not a new idea—we have seen examples of it following crises, and we have seen reform proposals during periods of relative calm. This financial crisis has unfortunately provided us with compelling reasons to press on with the regulatory reform agenda. As we do so, let's act on our best understanding of economic theory and the results of solid research. But let's also act on the basis of what we have learned directly from our firsthand experiences. ■

This article is based on remarks President Pianalto presented at the 19th Annual Hyman P. Minsky Conference on the State of the U.S. and World Economies Organized by the Levy Economics Institute of Bard College, April 14, 2010.