Alan Greenspan: Technology and banking

Speech by Mr Alan Greenspan, Chairman of the Board of Governors of the US Federal Reserve System, at the sixth annual reception for regulators, sponsored by Women in Housing and Finance, Washington, DC on 20 November 2000.

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I am pleased to join you this evening, and would like to thank Diane Casey, your former president, as well as Nancy Camm and the current officers for inviting me to participate. Women in Housing and Finance certainly deserves commendation for its twenty very successful years of providing a forum for individuals, particularly women, from across the spectrum of participants in the financial services industry to exchange views on policies and market developments. More important, I want to applaud the energy with which your organization is approaching its next decades of service. Clearly, we have witnessed a rapid evolution of financial markets in recent years, and the likelihood of continuing fundamental change is high. Your work in studying and interpreting these changes will be no less challenging in the years ahead than in the twenty past.

The remarkable innovations and adaptations that have permeated many aspects of our economy, especially in the most recent years of your history, are a part of the ongoing process of creative destruction that moves our economic potential forward as new technologies displace the old. Over the past decade, we have witnessed an acceleration of this process of change, not only in the real economy but in finance as well, with innovations that have swept through the banking, mortgage finance, and securities industries. These innovations have brought with them new products and services, and, of necessity, evolution in the approaches required of both managers and regulators. The unbundling of risk that accompanies the deconstruction of financial products into their constituent parts has revolutionized finance, irreversibly transforming the way services are provided, as well as by whom.

What is particularly impressive is that, fueled by both computing and telecommunications capabilities, the pace of financial innovation does not appear to be slowing. Technological advance has expanded the scope and utility of our financial products and - as I noted - has increased the ability to unbundle risks. It has also promoted the faster and freer flow of information throughout the financial system: we are quickly moving to real-time systems, not only with transactions but also with knowledge.

Of course, the process of change poses challenges to the institutions competing to adapt to the evolving needs of businesses and consumers. And it challenges those of us here this evening - policymakers, supervisors, and regulators - who are being pressed to reevaluate how we meet our responsibilities.

Although the safety net necessitates greater government oversight, in recent years rapidly changing technology has begun to render obsolete much of the examination regime established in earlier decades. Regulators are perforce being pressed to depend increasingly on greater and more sophisticated private market discipline, the still most effective form of regulation. Indeed, these developments reinforce the truth of a key lesson from our banking history - that private counterparty supervision remains the first line of regulatory defense.

The speed of transactions and the growing complexities of financial instruments have required a focus more on risk-management procedures than on actual portfolios. Indeed, I would characterize recent examination innovations and proposals as attempting both to harness and to simulate market forces in the supervision of banks.

The impact of technology on financial services and therefore, of necessity, on supervision and regulation is the critical issue that frames the supervisory agenda as we move into the 21st century. In today’s more complex world, the diversity of financial product choices facing consumers and businesses is truly astonishing. The complexity, as you know, has provided consumers with more choice but presented new challenges as well. In modernizing our banking laws and making them more consistent with marketplace realities, the Congress ensured that the financial services industry can expand and innovate with far fewer artificial constraints. How various financial providers choose to exploit these wider opportunities will be among the more interesting dynamics of the years ahead.

What will the financial services industry look like in WHF's 40th year? Given the rapidity of innovation and technological change, that is impossible to predict with any certainty. Accordingly, none of us can, a priori, lay out an optimal model either for financial services providers or for financial regulators. For policymakers, supervisors, and regulators, I would only suggest some general guidelines for the coming years: proceed cautiously, facilitate and participate in prudent innovation, allow markets to signal the winners and losers among competing technologies and market structures, and overall - as the medical profession is advised - do no harm.

We are all fortunate to have the opportunity to be a part of this remarkable transformation of the financial services industry into one that provides more useful financial products and services to a broader spectrum of consumers and businesses. As I see it, the possibilities for education and debate will abound in coming years, and you and your colleagues are well positioned to continue to provide leadership in addressing the broad spectrum of issues that will confront us.