LOOKING BACKWARD AND FORWARD AT TOM HOENIG, BANK REGULATOR

Retiring KC Fed chief has served the industry well

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When I arrived in Albuquerque as the new president and CEO of First National Bank, the bank was under a Formal Agreement with the OCC and a Memorandum of Understanding at the holding company with the Federal Reserve Bank of Kansas City. One of the first regulators I dealt with was Tom Hoenig, the then newly installed president of the Kansas City Fed.

I'd met Tom a couple of years before in my earlier capacity as special assets manager of Liberty Bank in Oklahoma City, when Tom was his district bank's executive in charge of supervisory activities.

What brings all this to mind was Tom's retirement last week as president of the Fed district bank and the interview that he granted to the local paper in Albuquerque that was published the other day. It took me back, and took me forward.

A regulatory "review"

The Comptroller's Office has a well-deserved reputation of maintaining a very professional bank examination force. As supervisor of national banks, it oversees about a third of the country's banks representing nearly two thirds of the banking system's assets, proportions that have been relatively steady over the last 15 or 20 years. In my new job, I had the opportunity to experience first-hand the different approaches to bank supervision between the OCC and the Federal Reserve.

The Federal Reserve banks examine state-chartered Federal Reserve member banks. There aren't very many of those any more (most state banks tend to be smaller in terms of asset size and are not members of the Federal Reserve). But the Federal Reserve has the increasingly important responsibility of supervising bank holding companies. The conversion into bank holding companies of many large investment banks three years ago swelled the Federal Reserve's portfolio of supervised firms, including some of the very largest banks in this country.

What struck me immediately was the strategic approach of the Kansas City Fed in discharging these responsibilities. The OCC was into credits--the safety and soundness activities--while the Federal Reserve focused on strategies with a forward looking emphasis. We were constantly challenged in our development of strategic plans and policies to stretch our thinking.

The difference in approach between the two entities, Fed of Kansas City and OCC, was at times striking. In the years that followed, I came to suspect that at least some of this was due to the personal influence of Tom Hoenig.

Hoenig in action on monetary policy

Nearly 18 months ago I began to see Tom's name mentioned prominently in the financial press. The president of the KC Fed serves, on a rotating basis, as a voting member of the Federal Open Market Committee.

For much of this year Tom sat on that committee as a voting member. Indeed, he often cast the lone dissenting vote on the deliberations of the committee's primary responsibility of establishing short term market rates of interest. Dissent, especially during Alan Greenspan's days as Chairman of the Federal Reserve System, and even now, is not a common thing.

So when Tom began to cast dissenting votes, it was newsworthy.

His primary concern has been that interest rates are being maintained at artificially low and unhealthy levels. Eventually, he believes, this will create new asset bubbles by providing too much credit to economic sectors that cannot efficiently or effectively use it.

One specific example of an asset bubble concern he has is the abundance of credit for the acquisition of farmland at acquisition prices that exceed the long-term rates of return from farming based on current agricultural commodity prices. In other words, he feels that the Fed is creating a bubble around the price of agricultural land.

Anyone who banks relatively well-to-do retired seniors has some appreciation of how their personal financial plans have been sent into disarray by the artificially low rates of interest created by the Fed's actions on retirees' short-term liquid assets.

Historical rates on relatively short-term CDs have over the last generation averaged consistently over 5%. But for almost the last three years they have hovered at levels near zero.

Capitol Hill latches onto interest rates

These dislocations are finding outlets somewhere in our economy and, Tom fears, will create disruptive shifts that are hard, if not impossible, to anticipate with any clarity or accuracy today. The retirees are starved for interest income while some other economic sectors are benefiting, perhaps in unhealthy ways.

Tom eventually found some support among other Federal Reserve Bank presidents, so for the latter part of his latest FOMC term, he's had some occasional company in his dissenting votes.

But these now public displays of disagreement on monetary policy are unfortunately creating focus on the political ramifications of monetary policy.

Politicians want low rates even though the circumstances may suggest that such rates are imprudent in terms of inflationary risks. Students of the Federal Reserve System are concerned that the Fed will increasingly become subject to political interference and control. This is not a trivial or insubstantial concern and will have implications for the conduct of monetary policy for many years to come.

Could Hoenig further serve the economy?

Tom hasn't made public what he plans to do in retirement. But as a vigorous 65-year-old with a trained economist's mind, he will likely find interesting and useful work.

Early in the year his name was floated as a possible successor to Secretary of the Treasury Timothy Geithner.

I don't know what Tom's politics are. But even one as far removed from Washington as I am knows that the Obama administration has a vested interest in low market rates of interest. So I doubt that Tom is likely to ever be a serious candidate for the Treasury position.

He's a smart fellow and commands the respect of his peers even as he dissents from the actions of his former colleagues. That's service of inestimable value to his country and to our industry.

Tom is also no fan of Dodd-Frank, for its complexity and heavy-handed impact on bank regulation. As someone now outside the industry, perhaps he will be a more effective voice of moderating the influence of this burdensome law.

How successful Tom's former colleagues and fellow dissenters will be in influencing monetary policy and the course of interest rates in the next few months is an open question and probably one of the most important facing our industry today.

It will be interesting to see what Tom does in coming years. I can't imagine he'll sit home and do the crossword puzzles for very long.

About Ed O'Leary:

Veteran lender and workout expert O'Leary spent more than 40 years in bank commercial credit and related functions, working with both major banks as well as community banking institutions. He earned his workout spurs in the dark days of the 1980s and early 1990s in both oil patch and commercial real estate lending.

O'Leary began his banking career at The Bank of New York in 1964, and worked at banks in Florida, Texas, Oklahoma, and New Mexico. He served as a faculty member and thesis advisor at ABA's Stonier Graduate School of Banking for more than two decades, and served as long as a faculty member for ABA's undergraduate and graduate commercial lending schools.

Today he works as a consultant and expert witness, and serves as instructor for ABA e-learning courses and has been a frequent speaker in ABA's Bank Director Telephone Briefing series. You can hear free audio interviews with Ed about workouts here. You can e-mail him at etoleary@att.net. O'Leary's website can be found at www.etoleary.com.

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