B of A Chief on Changes For Industry, Regulation

Kenneth D. Lewis, the chairman and chief executive officer of Bank of America Corp., delivered the commencement address Thursday at New York University’s Stern School of Business. During his speech he gave his thoughts on regulatory restructuring and the future of the industry. Following are excerpts.

Today, the needs of the commercial and financial world are great. You are graduating in the midst of a market disruption that perfectly frames the question of how can we best balance our pursuit of economic growth with our desire for market stability.

Answers to this question are important for every industry. But nowhere are they more urgent today than in financial services. ... It’s been almost a year since the credit markets first seized up last summer. All of us, from consumers to lenders to investors, have worked through a lot of pain. I think we’re probably not quite done, but I’m skeptical of predictions in this environment.

I think our time is better spent figuring out what we can do in the present to ensure more stable growth in the future. I certainly don’t have all the answers. But I have a few thoughts — for the financial services industry and for its regulators.

The prescription for banks is straightforward. First, build capital and liquidity strength, the ultimate defense against crippling losses in an economic downturn. ... Second, diversify revenue streams. ... Third, we have to improve our risk management tools and processes.

Regulators, of course, are taking action as well — and will take more before this is all over. I have a few thoughts on how we should approach our regulatory challenges.

First, transparency is important. But it should be accompanied by greater reporting simplicity. Transparency in the form of additional reams of information doesn’t help if the volume and complexity prevents true understanding.

Second, principles-based regulation, which is favored in Europe, gets a warm reception from bankers, because there are fewer rules — and who wouldn’t be for that?

Third, we have to decide whether major investment banking houses are “too big to fail,” or whether they are hotbeds of risky financial innovation that provide the spark for our capitalist economy.

They can’t be both.

I understand the argument for opening up the Fed’s discount window to investment banks in this environment. But I’d also say that providing a public backstop to an inherently risky business that is not required to backstop itself is a tough sell for taxpayers and carries no small amount of moral hazard.

Fourth, ... to the degree that we can push change through the system, it should always be toward simplification.

Fewer agencies, less duplication of effort, less political wrangling over turf. Bankers don’t want less rigorous regulation. We want clear, efficient, effective regulation that supports a strong and stable financial services industry. And we’ll support ideas for reform that move us in that direction.

I believe this downturn will accelerate consolidation in the banking industry across geographies, and in the financial services industry across product and market segments. ... Consolidation also will accelerate across product and market segments, bringing a wider range of financial products and services together in integrated companies.

Most relevant for New York, this means that the stand-alone investment banks of Wall Street will become a rarer breed. More will choose (or be forced) to combine with integrated commercial banks to gain balance-sheet strength and stability through economic cycles.

By the same token, many monoline companies that specialize in mortgages, credit cards or other financial services products will come under growing pressure to merge with partners that will provide more long-term diversity and strength for the future.

The last thing I’ll say about the future of our industry is that in the short term it may get somewhat smaller in the aggregate, even as it grows in strength and stability.

When financial innovations increase people’s ability to create value, the aggregate value of the financial services industry goes up — because people are willing to pay more for what we offer. Add those gains to growth in global GDP, and you’ll get an idea of how fast the industry should be growing over time.

I don’t know what that number is, but I do know this: Financial stocks’ share of the market value of the S&P 500 grew from 8% to 22% over the past 17 years. And over the past century financial workers’ share of U.S. income rose from 2.5% to 10%.

We’re not complaining — no surprise. But one could argue that the growth of the industry exceeded what was necessary at the margins. Even as the industry adjusts to a more normal growth trend, though, a few institutions are very well positioned to win market share and will recover and grow faster than others. These will be the long-term winners in the industry — those with the size, scale, market diversity, and ability to create value for customers and clients through innovation of new products and integration of services.

The full text of Mr. Lewis’ speech, and an accompanying op-ed piece that deals with the same issues at greater length, are both available at AmericanBanker.com.