Economic Commentary
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Challenges for Southwestern Financial Institutions: Resolution and Beyond

During the past decade the financial industry in the Southwest has undergone a dramatic restructuring. This restructuring results in part from the broad-based changes in market conditions, technology and the regulatory structure that have had an impact on financial institutions nationwide. Beyond these changes, the last four years brought the financial industry in the Southwest the most severe financial losses since the Great Depression.

A new financial landscape is emerging as the process of resolving these troubled financial institutions continues. The combined effect of the many failures, liquidations and assisted and unassisted mergers that have occurred at banks and thrifts throughout the region has resulted in large-scale industry consolidation. This consolidation may benefit the surviving institutions, particularly in lowered operating costs. The recapitalization, using both public and private funds, has improved the overall capacity of the Southwestern financial industry to finance economic activity in the region, which will benefit the Southwest economy.

Despite these improvements, the magnitude of the recent banking and thrift difficulties raised several complications that will influence the near-term operations of financial institutions. First, concerns persist that the large inventory of nonperforming real estate assets at the insolvent thrifts and elsewhere will reduce the asset values of the solvent competitors of these institutions. The high concentration of problem assets and uncertainty regarding the timing and method of their sale may be depressing underlying real estate values. Second, troubled real estate assets also complicate the resolution process because regulatory efforts to resolve the problem assets at the troubled institutions can place the unassisted institutions at a competitive disadvantage relative to the newly recapitalized firms. The negotiated assistance packages tend to include provisions that remove the negative impact on earnings from troubled assets, whereas unassisted competitors of these assisted firms must continue to finance their nonperforming assets or independently raise sufficient capital to cover markdowns.

These issues are particularly troublesome for the Southwest, which has many financial institutions with high concentrations of troubled real estate assets and many troubled financial institutions that will require resolution. Nearly 50 percent of the thrifts in Texas and Arizona are insolvent, and thus will require some form of resolution during the next few years. In addition, many banks that have already been resolved in the region can have an impact on the operations of those unassisted institutions. Despite these problems, efforts to resolve problem institutions must continue. Delays would only increase the ultimate cost of resolution.

The sweeping changes currently reshaping the financial landscape will challenge both financial institutions and policymakers as we proceed with the resolution process and move forward in the changing financial structure. These unique and changing times increase the need to stay abreast of market developments and regulatory changes.

In an effort to address the issues that confront financial institutions, the Federal Reserve Bank of Dallas and Southern Methodist University are sponsoring an open-forum discussion. The one-day conference, "Southwestern Banking in the 1990s: Resolution and Beyond," is scheduled for May 16. Sessions will feature presentations from banking leaders, real estate experts and regulatory representatives, along with audience participation. Main topics include managing through the resolution, the regulatory framework for the 1990s and market strategies beyond the resolution. Participants can expect a rigorous and informative discussion of the new opportunities and potential pitfalls facing the Southwest financial industry.