Journal of Financial Crises

Volume 4 | Issue 3

2022

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Sandra Ward

Recommended Citation
Ward, Sandra (2022) "Lessons Learned: Christopher Spoth," *Journal of Financial Crises*: Vol. 4 : Iss. 3, 222-223.
Available at: https://elischolar.library.yale.edu/journal-of-financial-crises/vol4/iss3/15

Yale Program on Financial Stability
Lessons Learned

Christopher Spoth

By Sandra Ward

As senior deputy director of the Division of Supervision and Consumer Protection at the Federal Deposit Insurance Corporation (FDIC), Spoth led examinations, enforcement actions, problem bank remediations, and failure resolutions, among a range of responsibilities. During the Global Financial Crisis, he was on the front lines of fast-moving policy discussions and actions to help stabilize the financial system, and he oversaw the closure and restructuring of some of the nation's largest banks. This abstract is based on an interview with Spoth on February 4, 2021; the full transcript may be accessed here.

Keep current: Assessing risk in real time helps the supervisory response.

As stresses in the subprime mortgage market surfaced in 2007 and triggered discussions about possible systemic impact on the financial system and economy, top FDIC officials began a review of the agency's supervisory program. Spoth recalled,

> It was clear that the supervisory process of regular annual examinations and other activities would be insufficient, because the information provided by those sources would be stale in a fast-paced crisis and similarly would provide insufficient tools to initiate the regulatory corrective actions that would be needed.

At the time, based on previously collected data, many of the banks and thrifts that would ultimately be deemed problematic were identified as performing strongly, Spoth noted. It became essential to access information that reflected current conditions in order to accurately determine the vitality of an institution. He said,

> Ratings drive corrective programs, including demands to raise capital liquidity, change management, restrict growth, and broker deposits. All those sorts of things are driven by what you can know about institutions or characteristics of groups of institutions. Importantly, current information provides the supervisory data needed to make accurate assessments of the industry in aggregate, thereby enabling policy makers and the legislature to take well-informed action.

Don't delay: Quicker response times are more likely to lead to better outcomes.

The crisis unfolded quickly, and it was challenging for regulators to keep pace with developments and achieve consensus on actions to take. In many cases, interagency and intra-agency conversations proved productive, and a course of action could be agreed on. Yet, particularly in conversations about larger banks, agreement was harder to come by. Spoth recalled,

> We had our own challenges at the FDIC. I was talking about downgrading institutions in a timely manner and taking corrective actions. Those are hard actions to take. . . .

> There were some interagency challenges that I would just characterize as unfortunate conversations going back and forth. One of the challenges to supervision is that you don't want to be too slow to respond, because unnecessary delay can make it more difficult to raise capital, change management, or sell an institution. It might not be possible to achieve those actions in some cases, but if you don't try early enough, it becomes progressively harder to do so.

Nonbanks continue to present real risks to financial system stability.

The Global Financial Crisis showed how interconnected the financial markets had become, and it exposed the increasing role of nonbanks in financial intermediation. The fragility of nonbank business models in a liquidity crunch, highlighted by the collapse of Lehman Brothers, is by now well known. What was unclear in the crisis and remains unclear, said Spoth, is the level of supervision over to nonbanks. That could be a problem, especially because nonbanks are now the dominant players in areas such as the mortgage business. Spoth said,

> Take as an example that most mortgage servicing is conducted by nonbanks. The states are addressing this issue, but I don't know if it is solved from a stability standpoint. There were also lessons learned about the money market funds breaking the buck under stress, but I am not sure that is solved. Problems arose in both mortgage servicing and money market funds when the coronavirus pandemic erupted.

Dated: September 2022

YPFS Lessons Learned No. 2020-34