

Trailblazers 2003 Conference

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Good evening. Standing before you is a form of life thought to be extinct hundreds of thousands if not millions of years ago--a dinosaur. Yes, that's me, a true dinosaur. I have worked for the same organization--The Federal Reserve System--since June 1968, over 35 years ago. That type of longevity is thought to be extinct, and for many of you I know it seems a remnant of the past. But you know, I have genuinely relished each of the 35 years, each job, the two Reserve Banks I've worked in and all the System assignments I have had. And, most importantly, I have relished the sense of pride that comes from contributing to the work of the world's foremost central bank. I've had other interesting opportunities, usually involving more money, but each time I've chosen to stay with the Federal Reserve System. Tonight I want to talk with you about why I've made that choice, and about how I see the challenges facing us in the Federal Reserve looking forward.

I remember that sunny morning in June 1968 as if it were yesterday. As I walked down Liberty Street towards the massive front entrance of the Federal Reserve Bank of New York, I felt the

sense of nervous anticipation that I know accompanies anyone entering his or her first job. My plan was to work for a few years, pay off my many college bills and then go to one of the graduate schools that had accepted me out of college. I did go to graduate school--at night--but I stayed a lot longer than I planned. And my career covered lots of jobs. I started as a bank examiner, then turned to applications analyst, public information specialist, cost accountant, budget and planning specialist, IT manager, senior officer in accounting, check and electronic payments, fiscal operations and most recently first vice president and president.

As I look back on it, three aspects of working for the Federal Reserve made the difference for me: our core mission, our culture, and our sense of community. The three C's, you might say.

First, the work of the Banks and the Board truly is central to the workings of U.S. and international financial markets. To work here is to work at the heart of things, if you will, to be at the core of what is going on financially. Whether you are examining banks, ensuring the Reserve Bank balance sheet is prepared accurately, processing checks, answering Treasury Direct

questions, or contributing to the formulation of monetary policy, the work we do in the Reserve Banks and the System makes a critical difference. This is never clearer than when a crisis hits the financial system or the nation more broadly. In fact, as I look back, the crises stand out almost more clearly than normal operations. From Banco do Brazil in the early '80s, to the Bank of New York and a \$22 billion + loan in 1984, to the 1987 stock market crash, computer failures, blackouts, and the Drexel Burnham failure to the Mexican and Asian problems of the mid and late 1990s and most recently, and tragically, 9/11, time and time again I have seen how important it is for the center of things--the U.S. central bank--to function in a way that is completely credible and highly effective. To me, the opportunity to contribute to this core institution has kept me going through the inevitable down periods of such a long span of time. Was every person I ever worked for inspiring -- no. Was every part of the Reserve Banks I've worked in exciting -- no. Was I never frustrated by bureaucracy or the unwillingness of some to see my view of things -- of course I was -- as I am sure all of you have been or will be. But the mission of the central bank -- its

essential work as the core of our financial system -- kept me hooked.

The second aspect of working for the Fed involves our culture. It is a culture that values and cultivates competence and true intellectual mastery. I hate to say this coming from Boston -- where one of most frequently asked questions of someone new seems to be "Where did you go to school?" or, worse, "Where did you prep?" -- but in most of my years in the Federal Reserve System it has mattered little where someone went to school. Reserve Banks in New York and Boston were willing to hire from other than the Ivy League before the rest of the financial world. And I can tell you from personal experience that when major banks in New York were telling women that they could not participate in management training programs *because they were women*, the New York Fed was willing to try. Increasing diversity--of gender, race, economic experience, or viewpoint--is a challenge that faces all the Banks and the Board still, but I would argue that the Fed's real focus on competence has featured prominently in shaping its culture.

What has this intense focus meant for me? Well, it has given me both the opportunity and the incentive to become deeply involved in the subject matter of the areas in which I've worked, and to succeed by being able to demonstrate both breadth and depth of understanding. It has also given me the opportunity to work for and with people who themselves were and are masters at their trades. Usually, not always but most of the time, the self-confidence associated with being a real expert led to a willingness to share information and bring others--like me--along. I owe a lot to those colleagues and mentors and to our culture of competence.

The last aspect of my experience in the Federal Reserve is one that engages me more with every passing week. That is our involvement in our communities. One of the most surprising things to me nine years ago during my first year being president of the Boston Fed was the stature the Bank has in its New England community and the respect in which it is held. Whenever any one of the states has a particularly thorny economic or fiscal issue, they usually look to us to help. Our publications are widely read, our economists and other officers are sought-after speakers;

we're expected to take lead roles in civic groups, and our community development specialists are well known and active in all the New England states. And I am not just touting Boston here. Whether it's the credibility that comes from the central bank successfully achieving its mandates, or the personal stature of people like Si Keehn, or Jerry Jordan, just to name two former colleagues, getting closely involved with key issues in their cities, Reserve Banks play key roles in their community.

For me as I became a president, the ability to contribute to real positive change in my community widened my horizons. It was something quite powerful and of real meaning. Now, of course, I knew that one of the reasons the U.S. has a regionally organized central bank--with 12 separate financial entities, not one as is the model almost everywhere else--was to ensure that regional perspectives would be included in national policy making. And I also knew our regional structure works the other way as well. We in the Banks bring policy decisions back to our regions, help to explain them and, if we do our job well, increase the credibility of the central bank by achieving a broader understanding of the difficult tradeoffs sometimes involved in

policy making. I knew all that, but it was still a surprise how much the community looked to the Boston Fed as an honest broker and a regional resource.

And the ability to become involved is not, and should not, be the province simply of the president of a Reserve Bank. In all the Banks, staff are held in high regard. When we reach out to help in education reform, or in the initiative to educate low income workers about the earned income tax credit, or when we sponsor conferences on angel-investing in women-owned businesses--just a few examples from Boston--several things happen. First, we continue a tradition of being involved and we contribute to needed endeavors moving forward. But even better, the staff involved gain substantially from the sense of accomplishment and from the added glow of giving back a bit. Obviously, we have to be careful about what we do and avoid possible political or other implications. But Reserve Banks are vital parts of their communities and that involvement is an aspect of my job that continues to reward me with each passing year.

Our central mission, a culture of competence, and a sense of service to community--these all contributed to creating the

dinosaur that stands before you. But, I may be part of a dying breed--I hope not, but there are significant challenges facing the Federal Reserve System. These challenges have the potential to change, and if we are not careful, destroy critical aspects of the System that have led so many of us to spend our careers here. These challenges also pose opportunities--opportunities that will enhance the Federal Reserve if we can take advantage of them. I want to talk about three challenges and their related opportunities tonight: the challenge of change, the challenge of markets, and the key challenge of leadership.

First--change. I don't think anyone in this room would debate that the Banks and the System face a pace and significance of change that is unparalleled in our experience. The payment system is gradually becoming fully electronic; cash volumes have flattened; the Treasury is wedded to completely electronic services; the financial industry is ever more consolidated; new risk management techniques and Basel II in whatever form it eventually takes will forever change supervision; and the challenge of a low inflation, high potential economy stresses our economic models. I would argue some of this

change works to make Reserve Banks even more important than we have been. Examining banks in the aftermath of Basel II, just as an example, will be very challenging and will involve attracting and keeping examiners with a whole new set of skills. Similarly, in research we have not yet begun to understand all the policy implications of high productivity and low inflation. But if I were to ask most of you about the most significant area of change, the likely response would be the impact of the decline in check volume and the related downsizing of Reserve Banks and branches, and the closing of RCPCs. And that would likely be true for those of you not involved in financial services, given the breadth of the effect of the changes in this large operations area.

Now, when I first started at the Federal Reserve Bank of New York, RCPCs were just coming into being. They were a headache, if not a nightmare, to implement and there were some who did not agree that Reserve Banks should be playing such an activist role in the check collection process. For the thirty years or so since then, Reserve Banks have worked not only to increase the efficiency of check collection, but also to eliminate the check by transforming it into some form of electronic

payment. We never attempted to regulate the check away as we believed market forces would do that more effectively and efficiently than we could. It took a while, but now that's happening.

Unfortunately, it's been hard for many of us to look at this as the definition of success. Each time check comes up in conversation, faces turn gloomy and leaders focus on all the very difficult aspects of downsizing and achieving the right balance of costs and revenues in a declining business. Such fundamental change is hard, but to quote a colleague "change is exciting." It's exciting that the U.S. retail payment system is finally moving from paper to electronics; it's exciting that we are all being challenged to do things, especially in the support and overhead areas in new and more efficient ways. Clearly it is not exciting to close offices, or move out of or sell Branch buildings as some Districts have chosen to do, but figuring new ways to serve the payments system and our communities can be. And this excitement can lead to more vital Reserve Banks if we let it.

As I look forward, I believe that if we're smart we are going to be able to deal with the cost revenue challenge of this

declining business. We need to become smaller--that's a reality. But we also need to serve the public interest and I think fulfilling that aspect of our payments system mandate will become more pressing as time goes by. Moreover, as the industry adjusts to the same issues, there will be opportunities to fashion new services and think in new ways. We are making the important transition to a wide variety of web-based information and transaction services in the payments area, helping to serve our customers, and the whole payments system with leading edge technology. And the Treasury is constantly challenging us to implement new electronic payment and collection processes. Finally, the passage of Check 21 will serve to incent an even faster conversion from paper to electronics--and we'll be there to support that. There's plenty to do in the payments arena, and lots of challenge, now and as check volumes inevitably go away.

When major life-changing events happen, it's easy to let oneself focus solely on the past and mourn what might have been. Thus, it is understandable that you, and those who work for you have a sense of loss and uncertainty about our future. It

is easy to see what's going away more clearly than the opportunity that lies ahead.

But, at some point people get over the changes life throws at them and move on. So my advice to all of you is "get over it." Check is going away; that's a good thing. For people like yourselves, handpicked to be among the leaders the System will count on for the future, this is the time to recognize that this change is inevitable, to embrace it, and welcome the opportunities it brings.

That takes me to the challenge of markets. We pay a great deal of attention to markets in the Federal Reserve System--how they function, how their reaction will affect economic growth, etc., etc. But do we really spend the time we need understanding the markets in which we work? Two areas come to mind here. As I noted before, I believe supervision will be challenged by the implementation of Basel II in whatever form that takes. Much of this proposal's development has taken place as a result of close interaction with key market participants, and input from these participants in the various quantitative impact studies has been important to its progress. I would even venture to say that

aspects of Basel II may be out ahead of the capabilities of some major institutions. But when the dust settles on this proposal, the industry will move fast with new techniques and approaches to risk management.

We will be challenged to keep our own understanding up to speed; we'll be challenged to attract and keep increasingly sophisticated examiners, and we'll be challenged in our ability to question increasingly complex approaches to risk management. This is not just a specialized staff or a Board issue. Things were fairly quiet on the banking front through the last recession, but my experience tells me that won't always be the case. When the inevitable hits the fan, the local Reserve Bank must be able to intercede effectively. To do that, we need to understand the many complexities of this evolving approach to risk management at senior levels in Reserve Banks. And, to do that, we will need to be increasingly outwardly focused.

The second area involves our favorite subject: checks and cost control. Should we have known more about what was going on in payments markets more generally? Could we have better anticipated the rate of change we're now facing? One way we

found out about the declining overall volume of checks was to conduct an intensive research project in 2001, but that was the first of its kind since the late '70s. As we move forward, understanding payments markets better is critical both to providing needed services and to assessing where things are going. And this can't be simply a sales effort carried out by the Customer Relations and Support Office. All of us have to be involved if we are truly to be able to manage our collective future.

Similarly, have we been too inwardly focused in our support and overhead areas--are there technologies and approaches that others use that can save us money and help us do our job better? All of the change in payments and IT has served to make some believe that Reserve Banks themselves are threatened. I don't think that is a foregone conclusion, but we can make it so. If we don't reach out to the markets we serve to understand them better, if we don't embrace the best ways of doing things, if we don't use public money effectively, then the future of the Reserve Banks is threatened. But if we can work to be more outwardly focused organizations--albeit smaller and in many ways more specialized--I think we can retain our viability and vitality.

And that, of course, takes me to the last challenge--the challenge of leadership. The Reserve Banks, and the Board as well, have developed leaders in their organizations who are highly competent and clearly focused on the mission of the central bank. But we can suffer from what might be seen as tunnel vision. Our culture of competence, our individual Reserve Bank organizations, and the demands of professional expertise in most fields can lead to a myopia that comes from the intensity applied to solving the issues at hand.

Going forward I believe leaders at all levels in Reserve Banks will need to be engaged as much horizontally within their organizations and across Reserve Banks as they are vertically. Currently, every function has its own System group but these groups are focused on largely specific areas. Focus across those areas comes at the Conferences of First Vice Presidents and Presidents, though at least in financial services a group of senior managers exists to address matters across the product offices. I would argue that cross specialty groups need to exist at much lower levels as well. They will be necessary, I think, as Banks approach the emerging area of risk management, and I think they

are vital to developing staff who have a keen sense of the breadth of what happens in a Reserve Bank. For me the question is not the old one of generalist vs. specialist--we cannot survive without professional competence--but one of those "professions", if you will, ought to be that of "central banker." Your time here in the Trailblazers program, and the colleagues you will come to know from other Banks and other "legs of the stool" will help you to prepare to be one of those "central bankers."

In closing, I'd like to pose a question that I ask myself with some regularity. Is the Federal Reserve changing in ways that make it less likely to be a place that good people will want to spend a career? Maybe not be dinosaurs, but spend 10 or 20 years? Certainly the Banks are downsizing and functions are being consolidated, but paper processing is not at the heart of the mission of a central bank. Creating a better, more efficient payments mechanism is; finding better ways to examine banks so as to promote financial stability is; and developing better approaches to meeting our twin policy goals of price stability and maintaining sustained growth is. Our shape is changing, to be sure, and we will need to work to reach out to markets and to

evolve our leadership, but the core mission, the culture and the commitment to community remain. That's what creates dinosaurs.

Thank you.