

**Y2K and Monetary Policy:  
Two Issues but One Goal**

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**The Bluecoats**

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Good evening, ladies and gentlemen.

It is my great pleasure to welcome the Bluecoats and your guests to the Federal Reserve Bank of Cleveland. We are honored to have this privilege of hosting your distinguished group for your Annual Spring Dinner. I believe that having your dinner here in our facilities is quite appropriate, given the common goal that our organizations share. We in the Federal Reserve, like the men and women whose families you support, are committed to serving the public and operating with the best interest of the public in mind.

I hope that many of you were able to take part in the tours of our Bank which were provided earlier. It is with great pleasure and pride that we open our doors to you and other members of the community to show you our facilities and our operations. But more importantly, it is to provide you with a better understanding of the Federal Reserve System and the Federal Reserve Bank of Cleveland. From time to time, through various occurrences and situations, I am reminded that many people know very little about the Federal Reserve and what we do. Some of that is our own doing, since the Federal Reserve has historically maintained a low profile in the public eye. But our “mysterious” role has also been due to the limited press that we have

received from the media – which is a good thing. Given the nature of news reporting, our absence from the headlines is an indication to me that our operations are running effectively and that there is nothing “newsworthy” to report. However, there is a need to develop a greater understanding by the general public of the role of the Federal Reserve in the economy because we do – both directly and indirectly – have an impact on everyone’s lives. So we are taking some actions – such as hosting meetings of organizations like yours – to remove some of the mystery surrounding the Federal Reserve to develop a better understanding of our role.

Two issues which have not escaped the attention of the media and that I want to address this evening are the Year 2000 Century Date Change and, what the Federal Reserve is probably best known for, monetary policy. These two issues may seem totally unrelated, but in the Federal Reserve System we address them with a single overarching goal in mind. That goal is the preservation of a sound financial system – financial conditions best suited to supporting sustainable economic growth.

I’ll begin with the Year 2000 issue.

I have no doubt that most of you have heard the wide range of opinions and predictions about what will happen on January 1, 2000. From my perspective, I am becoming increasingly confident that with respect to the U.S. financial world, and the variety of systems that support it, not much will happen.

The key factors in my level of confidence in the financial industry's readiness for Y2K are the amount of effort and activity that has gone into preparing for the century date change, and the fact that the industry as a whole has an impressive record of successfully dealing with operational challenges. From blizzards to power outages to major software failures, the industry has remained flexible and has built sophisticated and extensive back-up capabilities. The industry knows how to solve problems when they occur, and how to resume operations as quickly as possible.

Glitches will certainly occur, maybe even large ones. But with adequate contingency planning and event management, glitches can be contained.

Each day over \$2 trillion passes through Reserve Bank books representing the settlement of the U.S. Government securities market, the Eurodollar market, the dollar leg of all other foreign exchange transactions, settlement for a wide variety of security and bond markets, about 66 million checks and 16 million ACH payments, among other things. As such, we recognize the important role that the Federal Reserve plays in the U. S. and global financial industry. Thus, Federal Reserve concern from the beginning has been that our systems and those of depository institutions be Year 2000 ready as soon as possible.

Reserve Banks began Y2K project efforts more than two years ago. By the middle of 1998, all of the systems that Reserve Banks use to interface electronically with depository institutions had been made Y2K compliant and were ready for testing with customers. Early this year, nearly all our systems, both external and internal, were renovated where necessary and tested, and those systems are now in production. This means that the systems that Reserve Banks use in providing financial services today are Y2K compliant. These systems function today exactly as they will in the new century.

Moreover, these are the same systems that are being used in test mode with depository institutions; thus they are also being stressed continually with the variety of test scenarios used by those institutions. About 8,000 of the 12,000 depository institutions that connect electronically with Reserve Banks, including virtually all major banks, have tested their connections with us. These tests have been going well. Recognizing that nothing can be fully guaranteed, I am as confident that Federal Reserve systems and their customer connections will function without fail in the new century.

The Federal Reserve has also been working with the other federal banking agencies to examine every federally insured depository institution in the country for Y2K readiness - not just once but several times. The banking agencies have established milestone dates for completing all phases of Year 2000 preparations, including the completion of contingency plans by June 30 of this year. We have found that banks are making excellent progress in meeting these milestone dates, with close to 97 percent of all banks making satisfactory progress. We are requiring banks to assess customer and counter-party risk and take steps to mitigate those risks, and we are overseeing major service providers and software vendors as well.

What about financial services firms beyond commercial banks? Much is being done there as well. Major securities firms actually began Y2K efforts somewhat before the banking industry and have successfully conducted at least two extensive tests of their systems.

The dependence of the financial sector on various utilities, especially power and telecommunications, has been recognized by those charged with national Y2K coordination. The President's Year 2000 Conversion Council has a financial sector workgroup, chaired by the Federal Reserve, that is working closely with utilities to ensure problems are addressed and priorities are clear. Reliable utility operations are expected especially from major vendors, but less is known about small carriers and services in small communities and rural areas.

U.S. Government agencies have been seen as challenged in several reports, and some are thought to be behind schedule in fixing some mission-critical systems. However, those systems that most directly affect the financial world - those in the Treasury and Social Security - appear to be in good shape. Social Security systems are renovated and tested, and are now fully in production in Y2K mode.

In general, foreign entities are seen to be behind their U.S. counterparts in both the private and public sectors. The Gartner Group reports that the United Kingdom and Scandinavia are on a par with the U.S., while Germany and Latin America are further behind. Not surprisingly, developing countries are seen to be behind the developed world in their progress to prepare for the century date change.

On an optimistic note, I view the relatively glitch-free implementation of the Euro in January as an indication that Europe is likely to be ready for Y2K. A number of systems in some institutions were made Y2K compliant when the changes needed for the Euro were made. More importantly, institutions demonstrated the ability to meet a time bound, technologically complicated deadline albeit one with a more narrow impact.

In sum, then, Reserve Bank assessments, and reports and surveys done by others on the state of Y2K readiness, all point in the same direction. The financial sector - especially domestically - and the needed utilities that support it - are highly likely to succeed in making a smooth transition to the new century. Risks remain - most clearly in the foreign sector - and

glitches are inevitable, but with every passing day the likelihood of success is greater.

Beyond the actual renovation of computer code and testing of programs, recent effort to prepare for the year 2000 transition have focused on contingency planning. The Federal Reserve has devoted much attention to the matter of liquidity for individuals in the form of cash. While the nation's major ATMs are generally compliant now, and the likelihood of bank problems is small, we have recognized the public may choose to hold more cash as a precautionary measure. To address that, Reserve Banks will have extra cash available to increase the amount in circulation if needed. Based on normal growth, U.S. currency in circulation should increase to close to \$500 billion by late 1999. About two-thirds of that is held in foreign countries, so about \$170 billion will be in circulation in the United States at year-end. In addition, Reserve Bank vaults hold about \$150 billion in reserve. That amount will be increased by \$50 billion by late 1999 simply as a precautionary measure. We do not believe that the public needs to hold excess cash. On the contrary, as Chairman Greenspan stated in recent testimony, the safest place for individuals to keep their cash is in the banks, where it is protected and insured. However, we recognize that there will

likely be some increased demand for cash, and we remain committed to meeting any additional demands of the public. That means Reserve Banks will have sufficient currency in reserve to more than double the amount in circulation domestically, in the highly unlikely event that this is necessary. One remaining issue that we're working hard on is how to ensure that this large amount of valuable paper is where it is needed, rapidly and securely. Plans have already been developed to address these storage and distribution issues.

Finally, let me reiterate the necessity for continued focused attention on Y2K. Despite my reassuring assessment, much remains to be done, and there are no guarantees of total success. Everyone must concentrate on his or her own piece of this effort. However, through careful planning and adequate event management, we believe that the year 2000 transition will be smooth, and that – like the Federal Reserve's operations – the transition will be newsworthy only to the extent that operations are running effectively and that there is nothing to report.

Now, let me turn to monetary policy. I can assure you that the attention that we are directing to the Y2K issue has not distracted us from giving careful attention to this responsibility.

[Sandy Pianalto's email on 4/28 said that Jerry Jordan would fill in this part.]

### **Closing Comments**

In closing, I'd to again thank you Bluecoats for the work that you do and your commitment to those in need. I am truly pleased that you have chosen the Federal Reserve to host your Annual Spring Dinner. I hope that you will thoroughly enjoy your visit with us.

And now, if there is time, I'll be glad to respond to a few questions.

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