OBJECTIVE: PERFORMANCE

Remarks by

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at the

Federal Reserve Bank Open House

September 8, 1973

I'm delighted that you've all now had a chance to look us over in our new garb at the Federal Reserve. I'd be less than honest if I didn't say that we were very proud of our new home. Frankly, it's hard not to have just a bit of a swelled head living in that unique and magnificent building across the street, especially after having seen our picture in *Time* magazine a couple of weeks ago.

But if there's any pride on my part, it's certainly not personal. I am simply the heir to a tradition of innovation and sense of quality that have been the hallmark of the Ninth Federal Reserve District for many years. Rather, my pride is on behalf of my colleagues, past and present, who had such evident foresight and imagination in the conception of our new building. And I'm glad to be part of an organization, especially a public organization such as the Federal Reserve, that agreed to let this bank strike out in new directions rather than pile one stone on top of another as is so often the case in public architecture.

If our new home in downtown Minneapolis has added a new dimension to this historic Gateway area, it is only fitting that what goes on inside our building should likewise take on new dimensions. Just as a few weeks ago we dedicated our plaza to the citizens of the community for their enjoyment and use, so we are now dedicating ourselves to a higher quality of service to you, our constituents, and to the broader community that we all serve. Certainly our new facilities provide us with the space to go about our tasks as central banker in a more efficient manner. And I think that you will find that our staff has already caught the spirit of our new quarters, and will do everything in their power to see that we live up to your expectations of continuing improvement in service.

Improvement, however, does not come about automatically, or simply because we wish for it, or talk about it, or because we move into a new building. Improved service and improved performance come about only if we consciously make plans to achieve certain objectives, and then check back to see how we're doing. I believe this is as true for the Federal Reserve as it is in your own operations.

In fact, as you know, it has been one of the System's objectives for some time to update and make more efficient the payments mechanism on whose smooth functioning commerce depends. I have in mind, for example, the expansion of overnight clearance of checks to reduce float and minimize other problems associated with the paper check system. Similarly, we are about to bring on stream a computer-activated communications switch that will tie our District into the nationwide electronic funds transfer system. Armed with these powerful new tools, it is our expectation and intention that a growing proportion of payments be made by wire rather than through the use of cumbersome checks.

More locally, we are actively involved in the planning and implementation of a Scope project, designed to effect payments within the metropolitan area through exchanges of computer tapes or eventually by direct transmission, again with the intent of reducing the amount of paperwork. At the same time, we have expanded our facilities to provide coin wrapping services for banks in the District, and are trying to speed up our delivery of currency and coin to member banks. In another area, we are employing computer technology to speed the adoption of so-called book-entries on tape or disks as the method of recording security custodies, thus eliminating drawer upon drawer of physical securities and hopefully assuring a higher standard of performance in coupon collections and security payments.

I could expand this list of innovations, but I think the point is clear. We intend to use our new facilities to bring you and the public better service. In that connection, I think it might be useful for you to know the kinds of goals that we have set for ourselves, so that you will be in a better position to appraise our performance. At the urging and with the assistance of our Board of Directors, we have set down in writing the following goals as a broad guide to the kinds of contributions that we believe we ought to be making in the Ninth District.

1. To be an innovative component of the Federal Reserve System.
2. To make a significant contribution to the formulation and conduct of monetary policy.
3. To serve as a catalyst in fostering the growth and development of the Ninth District.
4. To improve services to government, banking, and the public.
5. To promote the strength and viability of the nation's financial institutions.
6. To develop a more effective work force and to provide leadership in the corporate community.
7. To improve the efficiency of Bank operations.

To give meaning and substance to these goals, we set for ourselves specific objectives that we expect to attain during the course of a year, both for the Bank as a whole and for the individual members of the management team. And at least once a year, we take a look at the record to see how we've done. I don't mean to imply that we have an infallible management system that guides us straight toward our target. But we do now have in place a structure that should help us achieve our own self-proclaimed intentions.

But it's quite apparent that no matter how successfully we strive to achieve the goals we've set for ourselves, we alone as one institution in this vast Ninth District can have only a modest impact by comparison with the collective potential of the financial institutions represented here today. It's for this reason, and in recognition of our common efforts to serve our community, that I would like to take this opportunity to suggest that we are not the only ones that might benefit from a more systematic setting of objectives and appraisal of performance.

I'm sure that many of you here today have had a management system in effect for many years. But I'm equally sure that there are many here who would argue that they're getting along just fine without all the nonsense of performance appraisals and the like. I'm certainly not here to try to tell you how to run your own businesses. But I would like to suggest that it is worth taking a systematic look at the kinds of services you are providing to your communities, and the efficiency with which those services are provided.

One of the projects on which we've begun to do some thinking attempts to determine whether there is any relationship between the nature of a financial institution in terms of its size, ownership, nature of management and so on, and the kind of performance that it turns in. To get any sort of a handle on such a study, one is forced to try to define the nature of the service that should be expected from a commercial bank.

And as you can imagine, this effort quickly leads one into some pretty ill-defined territory.

In broadest terms, there are perhaps four different constituencies to which a bank might be held responsible.

> The first, obviously, is to the local community that it intends to serve.
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> Second, though without trying to assign a ranking of priorities, the bank has certain responsibilities to its own employees.
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> Third, it's got to turn in a performance that satisfies the stockholders or owners.
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> And fourth, it has a role to play in the broader banking financial system of the United States.

In each of these categories, one can enumerate a rather lengthy list of services that can be measured, theoretically at least, in terms of their quality and efficiency. In the area of community service, for example, one thinks immediately of demand deposit and checking services, time and savings deposit services for the small saver, and similar services for the larger investor. Each of these in turn could be evaluated in terms of cost, freedom from error, breadth of choice to the consumer, and so on.

On the lending side, one could construct a similar array of types of loans and investments, including such items as participation in student loans and loans to minority businesses. Other dimensions that ought to be on such a checklist include the role of the bank in general community development, its range of services, the accessibility of such services in terms of hours of operation and so on.

Similarly, under the heading of responsibilities to employees, one could ask whether there exists an adequate training and development program, an effective commitment to equal employment hiring practices, and competitive compensation and fringe benefits. And so on for the other broad categories of responsibility. Now anyone who has attempted to set up such an evaluation system knows that precision is a goal that is never attained. But by the same token, the effort to define areas of service and responsibility, and to come up with at least some crude measure of performance, is an eye-opening education that we at least have found to be worth the effort.

As one tries to make comparisons between one bank and another, it quickly becomes clear how difficult, if not impossible, it is to weight various characteristics one against another. For example, in any given community, it may be perfectly appropriate that one bank concentrate on providing a narrower range of services in a particularly efficient or helpful way, whereas its competitor is providing a broader range of services, but perhaps without the same efficiency. Can one say that one institution is necessarily better than the other? I doubt it.

And yet as our staff travels around this District, we can't help but form impressions of the kind of performance that banks are rendering to their communities and to their other constituencies. Rather than have these impressions formed on the basis of casual observation, I think that you and we would be better served if we had in the back of our mind, if not in our pocket, a checklist along the lines that I've tried to sketch. Hopefully, over time and with experience, we might be able to draw some useful conclusions about the kinds of banks and kinds of managements that fall at one end of the scale of performance or the other. Indeed, at some point, if there were wide general acceptance of some form of performance appraisal along these lines, it might be worth suggesting that the chartering authorities for banks, of which I hasten to point out we are not one, take a look at such appraisals in deciding whether there ought to be periodic renewals of bank charters.

Another broad area in which performance appraisal is being applied by some of our member banks, and could be applied by others, is in comparing their costs for a particular service with those of other banks in their size category. I'm referring to the Fed's system of functional cost analysis which many of you have found to be a useful management tool. Again, I have no intention of getting into the technicalities, but I would urge that those member banks that are not familiar with what we have to offer in this area get in touch with Doug Hellweg. I think it's rather remarkable, for example, that among member banks in the 20 to 30 million deposit size category, the most efficient banks can process a demand deposit transaction for half what it costs the least efficient. And the range of costs in other operations indicates to me that were I at the upper end of such a range, I would be trying to find out what the best performers were doing that I wasn't.

Obviously, accurate cost data are an essential ingredient in the pricing of services, and in determining return on equity. Again, it would be interesting to see what these cost data might tell us about the relative efficiency of different size operations in different communities, and whether there are any patterns of performance that seem to reflect particular forms of banking organization.

I would also hazard the guess that more accurate cost data might avoid some of the emotional responses to changes proposed from time to time in the payments mechanism. I have in mind, for example, the dire predictions about the impact on bank profits, and even on the continued existence of some banks, of shifting from nonpar collection to par collection. To my knowledge, no bank was caused to fail by this long overdue structural change. And if particular banks' profits have suffered, I would like to see the before and after evidence. Similarly, there was a good deal of opposition to the Federal Reserve's proposals last year for changes in Regulations D and J on check collection procedures. I am sure that some banks on balance lost earning assets as a result of these changes designed to speed check collection and reduce float. But I'm not aware that the effects in any instance have been so severe as to have justified the efforts of certain groups to continue to live on float. Finally, while I'm on the subject of controversial changes, I might as well say that I think many of the fears we hear expressed about the consequences of moving toward uniform reserve requirements for similar kinds of deposits are also greatly exaggerated.

Just as modern management systems do not assure good management, so accurate cost data do not assure appropriate pricing of services. But to my way of thinking, we in the Fed can be of some assistance by providing a method of looking at costs and a basis of comparing those costs among similarly situated institutions that can be of real help to members.

Another area where it would be useful for banks to establish more formal objectives concerns so-called liability management. Particularly in the larger money-center banks, there has been a conspicuous trend toward reliance on sources of funds other than traditional deposits as a means to finance loan extensions and investments. At the same time, many banks have come to base their plans for meeting credit demands during periods of tightness on their ability to buy deposits or non-deposit liabilities, rather than on the more traditional source of funding, namely, liquidation of short-term securities.

There have been any number of incentives for moving in this direction, and within bounds, these trends have probably made sense. The real question, of course, is at what point these bounds have been overreached. We in the Fed are struggling with this very question at the moment, and I have no great hope that we will be able to come up with a definitive answer where others have failed in the past. But I have already been impressed with the need for conscious management decisions regarding the prudent relationship between asset and liability structures in differing credit conditions. Again, no formulas or ratios alone are going to prevent a bank from becoming overextended. But the conscious establishment of specific norms should at least serve as early warning devices so that bank lending policies can be reappraised at an earlier time than they might be otherwise.

One of the specific variables that banks have perhaps not had under as close surveillance as they should is the total of their loan commitments or lines of credit. As many of you know, the Federal Reserve and other regulatory agencies have been making a conscious inquiry in their examinations of the larger banks into the relationship between unused loan commitments and sources of funds under varying credit conditions. We would like to assure ourselves that a plan for financing such commitments does in fact exist.

As you might imagine, we have found a very wide range of variation among banks as to the amount of attention that has been paid to unused commitments to lend. Some banks do not even keep a running total of such commitments, while others have a very specific management plan approved by the board of directors as to the amounts that could be outstanding and the methods by which the banks intend to meet such commitments. I fully recognize that the degree of formality of such an assessment will vary greatly with the kind of exposure that a particular bank's business may imply. But I would urge that even smaller banks could well profit from a conscious look at their exposure.

Let me mention one specific area of bank service that we in the Minneapolis Fed are planning to look into. It's no secret that there have long been differences of view as to whether or not Indian reservations in this District are being accorded equitable treatment by financial institutions in the provision of credit. The tribal councils on the one hand argue that banks are reluctant to get involved with reservation Indians, and that many potential Indian borrowers are turned away at the door without even so much as an inquiry into the specifics of a given request. On their side, the banks understandably point to the lack of state jurisdiction over tribal lands, the related difficulty in assuring adequate protection in the form of collateral for business loans, and the considerable variation from one reservation to the next in the tribal rules applying to credit transactions. From our own inquiries, I know that there is ample cause for these conflicting views on both sides. At the same time, I know that there are banks that have made a strong effort to overcome the obstacles in the way of economic development loans on reservations, and there are other banks that have found the effort simply not worth the bother.

As part of a broader effort to see whether we could be of any assistance to tribal leaders, we have started to develop a system of cash-flow analysis that can be applied to tribal funds in order to give some assistance to tribal leaders in measuring the value of their deposits, and by extension, the amount of banking services that the tribe ought to be able to expect from its bankers.

This is clearly an experiment, but it seems to me that we ought to be able to provide to those who are less sophisticated in financial matters the kind of analysis and tools for appraisal of service that are part of the everyday relationship between the sophisticated corporate treasurer and his banker. Again, performance appraisal is at the root of this effort. And if it turns out to have any merit, I see no reason why the same set of principles could not be applied for measuring the value of banking services to other public authorities.

If there's a message in what I've been trying to say, it's that our promises to ourselves--we in the Fed and you in your own banks--of better service to our communities are more likely to bear fruit if we set for ourselves specific objectives and then go about appraising our performance in a systematic way. A second generalization is that we're more likely to carry out our good intentions if somebody is looking over our shoulder. In the case of the Federal Reserve Bank, our Directors serve that function. I can assure you that they take a lively interest in seeing that we lay out a program of what we intend to accomplish, and then take a look back to see how far we've got.

In a very different way, I think that we in the Fed can take a look at the operations of banks in this District to see to what extent the services actually provided live up to the norms that we should be setting for ourselves. Let me assure you that any attempt on our part to appraise performance will be designed not to point a finger of accusation, but rather to determine whether certain forms of organizational and managerial structure can be associated with better banking performance to a bank's various constituencies.

One of the groups within our organization to whom we will turn for help in these efforts is our examiners. Their specific assignment, not only within the Federal Reserve but in the other regulatory agencies as well, has been to assess the various aspects of sound banking practice and the managements of banks as a protection to depositors and the general public. But you are as aware as I that their role has changed with the times. Today we are asking them not only to tell us the quality of your assets, but also to see that Federal laws and regulations of a quite different sort are also being complied with. For example, they are expected to satisfy themselves that a bank is complying with the requirements for truth in lending, for fair credit reporting, for nondiscrimination in the granting of real estate loans, and so on.

If social concerns of this nature have gradually been added to the responsibilities of bank examiners, I would like to suggest that they might take on still another kind of assignment. Specifically, I think that they, and the rest of us in the regulatory agencies, could make a real contribution by keeping our eyes open for innovative ideas that could be passed along to bankers in other communities. In other words, rather than concentrating solely on minimizing risks and assuring compliance with regulations, we might be able to make a positive contribution to better performance and service on the part of banks generally in the District by passing along good ideas.

If my plea today has been for a more systematic appraisal of performance by banks in the District of their own affairs, and a hint that we in the Fed will be trying to do some appraisal work ourselves, not just of our own performance but of the performance of banks in the District, then I think it's only fair that you be encouraged to appraise us as well. After all, we recognize full well that we are not the repository of all wisdom when it comes to what's good in banking. Nor are we infallible in going about our assigned tasks. I'm afraid this was demonstrated recently in the successive amendments to the changes in Regulation Q ceilings on consumer deposits.

In the final analysis, though, I'm convinced that our goals and objectives are the same as yours. In any specific instance, we may well see things in a different light. The only way that we can reconcile our differences is through the frank discussion of our respective points of view. I have already learned that bankers in the Upper Midwest are not reticent about stating their feelings on an issue; I admire you for that, and I hope we can keep up the dialoque. I'm sure we'll both be the better for it.