For release on delivery
5:30 p.m. EST
February 2, 2011

From Community Banker to Central Banker – My Journey

Remarks by

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at the

University of North Carolina Kenan-Flagler Business School's Dean's Speaker Series

Chapel Hill, North Carolina

February 2, 2011

It is great to be back at the University of North Carolina. And I am most honored to take part in the Kenan-Flagler Business School's Dean's Speaker Series. I am a proud graduate of UNC-Chapel Hill. However, my area of study was not what most would consider a logical first step for someone who would one day become a central banker. I was an aspiring actress, and spent most of my time across campus at Playmaker Theater earning a degree in dramatic art. Tonight I have been asked to share with you some of the memorable experiences I have had since I was last in a Chapel Hill classroom--some of the amazing opportunities that shaped my journey from Carolina Playmaker to Federal Reserve Governor.

I'll talk a bit about banking and the important role lending plays in the economy. I'll describe how my banking career led me to a seat on the Federal Reserve Board and how that unique perspective helped me add value after I arrived there. I will then explain some of the actions taken by the central bank at a time of extraordinary financial uncertainty, and I'll describe some of the attributes that make the Federal Reserve an institution like no other. I'll end with a few thoughts that might resonate with the students in the audience as they conclude their studies and prepare to join the workforce.

Bye, Bye Broadway, Hello Boardroom

I chose a career in banking for one simple reason: I needed a job. Regardless of economic conditions, the acting profession has an unemployment rate of about 95 percent--or so it seemed to me at the time. So I looked for something I could do almost anywhere and with hours that would leave plenty of time to pursue my dream. I found a job as a part-time drive-through teller. Later when I needed a full-time job, I went to work in a start-up bank. And even though I didn't start out to be a banker, I found a career in that little bank.

The president of the bank was an old-fashioned community banker and a natural teacher. He taught me everything he knew about banking, and that was plenty. Fifteen years later, when he died suddenly of a massive heart attack, I had learned enough to take his place as chief executive officer.

My banking education began with him as my mentor and with plenty of on-the-job training. Because the bank was just starting up, there were only 11 employees. With lots of work to be done and not many people to do it, I was able to try my hand at nearly every job at the bank and to see the results of every action that was taken. One of those early jobs was reconciling the bank's account at the Federal Reserve and calculating the bank's reserve position.

Today, I spend a lot of my time thinking about the collective reserves held by all banks and how those reserves impact our economy. My early experiences with making reserve decisions for a tiny community bank makes it much easier to connect the dots between Federal Reserve actions to add or withdraw reserves, bankers' decisions to manage their reserve accounts, and the resulting impact on interest rates, which in turn influence economic activity.

The banking industry has a tradition of teaching basic concepts of bank management through in-house or industry-sponsored banking schools. Once I realized that my talent for banking was much stronger than my natural acting ability, I started going to banking schools to learn about bank investments, lending, and bank management. And I earned a masters in business administration while going to school at night. I soon began teaching bank management in the same schools I had attended earlier.

One of the best teaching tools I discovered was bank simulation. I worked with a number of models, helped design a few of them, and ran several hundred simulation exercises over the years. As issues have developed throughout the financial crisis and the recovery, I have had more than a few occasions to be grateful for the deep understanding of how banks and bankers react to various external conditions that I gained from all those simulations. I guess you could say that, though I was the teacher, the person who learned the most from those simulations was me. And I have discovered that the Federal Reserve uses its own models of the economy to simulate outcomes and create economic forecasts under a variety of assumptions.

Much of my time as a community banker was spent lending to small businesses. In many banks today, small business lending is an automated process that relies on computers to analyze data and determine a borrower's creditworthiness. For me, the process was personal. It involved sitting eyeball to eyeball across the table from my customer. More often than not, the customer was someone I knew well, and had been lending to for years. Occasionally, he or she represented the second or even third generation to run the business. Or the business itself was the second or third venture that I had financed for the same borrower. There were financial statements to be gathered and analyzed. Usually it was difficult, if not impossible, to separate the business and personal finances. But understanding the borrower's ability to successfully run a business was just as important as analyzing the numbers. I spent a lot of time talking to business owners about their businesses. In fact, sometimes I thought they came in looking for a sounding board for their ideas as much as they were looking for money. And I couldn't always make the loan.

At times, especially during the economic downturn of the early 1990s, I had to deal with problem loans. Some were resolved through restructure and some through foreclosure. Now, as a bank regulator in the middle of a financial crisis, this deep personal understanding of the lending and loan collection process strongly influences my policy views. And I have never lost sight of the importance of those small businesses to local economies or the importance of loan availability to small businesses.

From Community Banker to Central Banker

I fully expected to complete my career working as a community banker in my hometown. But in early 2007, I received a call asking if I would be interested in serving as a member of the Board of Governors of the Federal Reserve System. I was intrigued, flattered, and more than a little intimidated by the prospect. I had interacted with the Fed throughout my banking career and had even served on the Board of Directors of the Richmond Federal Reserve Bank. So I knew a lot about the Federal Reserve. But there was no way that I, or anyone else, could have foreseen the tumultuous events that were about to unfold.

The Federal Reserve is the central bank of the United States. The Congress created the Federal Reserve in 1913, after a series of banking panics, "to furnish an elastic currency, to afford a means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States and for other purposes."[1] When I joined the Board of Governors in August 2008, the Fed's ability to respond to financial crises was about to be tested as never before.

For as long as they have existed, central banks have calmed financial crises by

[1] Federal Reserve Act, ch. 6, 38 Stat. 251 (1913).

lending to financial institutions against good collateral. Because central banks step in when other sources of funds retreat, central banks acting in this capacity are known as lenders of last resort. But that phrase doesn't mean that central banks make bad loans; nearly all of their loans are to sound borrowers with sound collateral. Banks rely on short-term funding such as overnight interbank loans or customer deposits to make the longer-term loans their customers need. If funding becomes scarce, banks become less willing to extend credit. To maintain the flow of credit to businesses and consumers, the Federal Reserve provides short-term credit to sound depository institutions as needed. To ensure that banks use the facility only as a backup source of funds, Federal Reserve loans are made at an above-market rate.

In the Panic of 2008, liquidity needs were not confined to the banking system. The shadow banking system, made up of investment banks, money market funds, finance companies, and investors in a wide range of debt securities, provided a large part of the credit that fueled our economy. When panic set in, it froze lending in banks and non-banks alike and produced funding pressures across a wide range of markets and institutions. The actions taken by the Federal Reserve to fight the crisis were quite traditional in the sense that, for years, central banks have been providing liquidity by lending to financial intermediaries. But they were unconventional in that the concepts had to be adapted to fit markets and lenders that had never been supported by the Federal Reserve before.

Now, I didn't live through the banking crises of the distant past or those that might have occurred in other countries. But I can tell you what it was like at the center of the most recent crisis. Funding was drying up for one institution after another and for one market after another. Our efforts to provide liquidity were criticized by some as bailouts for the banks. I can understand how it could seem that way, but I also know that every action the Fed took was directed at improving the economy rather than the well-being of the banks.

We had to make many difficult decisions in the darkest days of the crisis. For me, the decisions were made a bit less difficult by several factors. First and foremost was the calm, decisive leadership by Chairman Bernanke, whose lifelong study of economics and economic history provided unique preparation for his own role in history. Almost as important were the hundreds of Fed economists, lawyers, bank supervisors, and market specialists who worked around the clock to craft creative solutions to every financial market challenge. I will never know how many hours it took to develop and implement all of the programs they presented in a series of emergency Board meetings. I do know that they responded to every question and strived to mitigate every risk that was identified. And while the strain was evident in their tired eyes, the collegiality and intellectual rigor that I have come to know as a hallmark of the Federal Reserve never wavered. Finally, for me, was the knowledge of all those small businesses that depended on credit to run their businesses.

The Fed provided credit to banks large and small. In addition, through other programs, we supported securities made up of loans to households and businesses, including loans for business equipment, for inventory, for insurance payments, for business credit cards, and for loans guaranteed by the small business administration. To be sure, lenders reacted to uncertain economic conditions and weaker borrowers by tightening credit standards. But, with liquidity provided by the Federal Reserve, loans to borrowers who met the tighter standards continued to flow. The U.S. economy continues to face challenges, but I am convinced that the forceful actions of the Federal Reserve in 2008 helped prevent what might have been a far worse scenario.

The Federal Reserve was originally created to guard against financial panics. But in modern times, many people think of its primary role as responsibility for monetary policy. The Congress has given the Federal Reserve two objectives, known as our dual mandate, to foster maximum employment and price stability. In its conduct of monetary policy, the Fed influences the level of output and the level of prices in the economy through changes to interest rates and credit conditions.

During more normal times, the Federal Reserve's policymaking is focused on short-term interest rates, our main tool for steering the economy. The Fed influences the costs of borrowing to buy everything from cars to condos to computers by controlling short-term interest rates. Interest rates can be lowered to stimulate borrowing and spending when demand is otherwise weak, or raised to dampen demand and curb inflation.

Before I arrived in August 2008, the Federal Reserve had already responded to the weakening in the economy by aggressively lowering its federal funds rate target from 5-1/4 percent in September 2007 to 2 percent. From a historical perspective, 2 percent is an extremely low level for interest rates. But as the financial crisis intensified and the economic outlook grew more dire in the fall of 2008, the Fed continued to cut rates. For more than two years now, our policies have held short-term interest rates close to zero.

Just as the Federal Reserve used traditional concepts in unconventional ways to provide liquidity to the shadow banking system and stop the panic, once our main short-term interest rate lever was effectively at zero, we moved beyond traditional monetary policy to purchase longer-term assets and push down longer-term interest rates. In November 2008, the Fed began purchasing large volumes of longer-term, U.S. government debt and agency mortgage-backed securities, eventually increasing the commitment to more than $1.7 trillion before completing the purchases in March 2010. Those purchases put downward pressure on longer-term interest rates generally and helped normalize the spread between mortgage rates and long-term Treasury rates, which had widened during the financial crisis.

Reducing longer-term rates influences the economy in much the same way as lowering the expected path of short-term rates. For instance, the decline in longer-term rates lowers the cost and increases the availability of capital and credit, which in turn encourages business expansion. In the most recent episode, another important result of lower rates has been a reduction in debt service burdens from existing debt. Households in particular have significantly reduced mortgage payments through refinancing. And numerous small business owners have told me that they could not have survived the downturn without low rates.

In November 2010, recognizing that progress toward the achievement of our dual mandate was disappointingly slow, the Fed decided to put additional downward pressure on longer-term interest rates by purchasing longer-term Treasury securities with a stated objective to purchase $600 billion by the end of June 2011.

So far, I have talked about what the Federal Reserve has done during the time I have been there. But I haven’t really told you what the Fed is or what it has been like to be a policymaker there.

The Federal Reserve is an independent entity within the federal government in that its decisions do not have to be ratified by the President or any other executive branch official. The Congress, through the Federal Reserve Act, sets the Federal Reserve's goals and oversees it, but the Federal Reserve decides independently how to achieve its congressionally mandated goals. The ability to make monetary policy decisions that are free of short-term political influence is critical for central banks. This is especially true because the effective conduct of monetary policy requires a long-term perspective. A central bank that is subject to political pressure might opt for policies that favor rapid expansion in the near term at the expense of higher inflation in the future. Such actions would surely result in the loss of the confidence and credibility that are needed to achieve the objectives of monetary policy. Indeed, research has shown that countries with independent central banks have better economic performance and lower inflation than countries whose central banks are not independent.[2]

The structure of the Federal Reserve is uniquely American in its decentralization. The Federal Reserve System is made up of the Board of Governors in Washington, D.C., and 12 Federal Reserve Banks across the country. The seven members of the Board of Governors are nominated by the President and confirmed by the Senate. Each Reserve

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[2] See Alberto Alesina (1988), "Macroeconomics and Politics," in Stanley Fischer, ed., *NBER Macroeconomics Annual*, vol. 3 (Cambridge, Mass.: MIT Press, September), pp.13-52; Vittorio Grilli, Donato Masciandaro, and Guido Tabellini (1991), "Political and Monetary Institutions and Public Finance Policies in the Industrial Countries," *Economic Policy*, vol. 6 (13), pp. 342-92; Alex Cukierman (1992), *Central Bank Strategies, Credibility, and Independence: Theory and Evidence* (Cambridge, Mass.: MIT Press); Alex Cukierman, Steven B. Webb, and Bilin Neyapti (1992), "Measuring the Independence of Central Banks and Its Effect on Policy Outcomes," *World Bank Economic Review*, vol. 6 (3), 353-98; Alberto Alesina and Lawrence H. Summers (1993), "Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence," *Journal of Money, Credit and Banking*, vol. 25 (May), pp. 151-62; Alex Cukierman, Pantelis Kalaitzidakis, Lawrence H. Summers, and Steven B. Webb (1993), "Central Bank Independence, Growth, Investment, and Real Rates," *Carnegie-Rochester Conference Series on Public Policy*, vol. 39 (1), pp. 95-140 ; and Alex Cukierman, Geoffrey P. Miller, and Bilin Neyapti (2002), "Central Bank Reform, Liberalization and Inflation in Transition Economies--An International Perspective," *Journal of Monetary Economics*, vol. 49 (2), 237-64.

Bank has a board of directors drawn from business, public, labor, nonprofit, and banking leadership within its district. In consultation with the Board of Governors, the Reserve Bank directors choose a president to run the bank.[3] The Board of Governors oversees the Reserve Banks and is responsible for formulating bank regulations; supervising banks; and for making decisions regarding lending, other than discount window lending, to depository institutions.[4]

The Reserve Banks provide financial services to depository institutions, the U.S. government, and foreign official institutions, including making discount window loans and playing a major role in operating the nation's payments system. Under delegated authority from the Board, the Reserve Banks also conduct on-site supervision of bank holding companies and state-chartered banks that choose to join the Federal Reserve System.

Monetary policy decisions are made by the Federal Open Market Committee (FOMC). While all 12 Reserve Bank Presidents and all members of the Board of Governors participate in FOMC discussions, the voting members of the FOMC are made up of the members of the Board of Governors, the President of the New York Reserve Bank, and four of the remaining Presidents on a rotating basis.[5]

The culture of the Federal Reserve is an interesting blend of government, academia, and business. Differences of opinion regularly occur, but they are a source of strength rather than conflict within the institution. They add liveliness to the debate and

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[3] Each Federal Reserve Bank's Class B and Class C directors appoint a president. See section 4(4), subparagraph "Fifth," of the Federal Reserve Act, as amended by section 1107 of Pub. L. No. 111-203 (2010).
[4] For a fuller discussion of the responsibilities of the Board of Governors and the Federal Reserve Banks, see *The Federal Reserve System: Purposes & Functions*.
[5] For more information about the FOMC, see www.federalreserve.gov/monetarypolicy/fomc.htm.

richness to the decisionmaking process. The System is a treasure trove of data, research, and institutional memory about the economy and the financial system. It is stimulating, and occasionally exhausting, to be surrounded by so much brainpower and intellectual curiosity. But everyone approaches the work with a serious sense of purpose and collegiality. It is hard for me to describe what it is like to work there, but if you ever get the chance to do so, I would highly recommend it.

Lessons Learned

This brings me to my final task--to offer some career advice to those of you just preparing to enter the business world. As someone who has spent more years than I care to count in that world, let me begin where I began. I needed a job just as many of you will soon. In searching for that first job or even some of the ones that come later, don't be afraid to take one at an entry level, as I did when I started as a teller, or one that seems quite daunting, regardless of your qualifications, as I faced when I joined the Federal Reserve. Look for a career that you enjoy and one that is well suited to your temperament and your talents. Remember that what you think you want most in life might not be the thing that makes you truly happy. I could have been miserable as a mediocre actress. Instead, I happened upon a deeply rewarding profession that I loved. Indeed, I have found that life usually works out for the best--if you let it.

Whether you have found your perfect career or just a job to pay the bills, make the most of every assignment. I told you earlier about my banking mentor, Burt Harrison. He was always loading me up with projects. One day, while I was struggling to dig my way out from under a mountain of work, Burt came to me with yet another assignment. I looked up from the task at hand and said, "You bring me work like you're bringing me presents." Burt huffed and returned to his office. He returned a short time later and said, "I *do* think they are presents." And he was right. Those projects taught me more than any class could have.

Finally, if, as I suggest, you are going to take advantage of all the opportunities that come your way, I would like to stress the importance of lifelong learning to develop the skills that will be needed to tackle new challenges. You might very well find yourself pursuing a direction different than the one you trained for in business school. But the lessons you learn here will still be important. You will need to apply the concepts you know to situations that are different than those you expected to find. And you may need to learn new concepts. Your ability to think critically and creatively, along with your skill at tracking down the information you don't have, will be among your most valuable assets. Remember that, sometimes, asking the right questions is just as important as knowing the right answers. And if you get a chance to teach others, take it. Nothing solidifies your understanding of a subject like having to communicate it clearly to others. Use everything you have learned so far, take advantage of any educational opportunity that comes along, and apply what you learn. It is one investment that I can guarantee will yield an enormous return.

Conclusion

In closing, I'd like to make a shameless plug for public service. Putting your knowledge and skills to work for the good of the nation is a very high ideal. I think Woodrow Wilson--the President who inspired the Federal Reserve Act--said it well, albeit long-windedly: "You are not here merely to make a living. You are here in order to enable the world to live more amply, with greater vision, with a finer spirit of hope and achievement. You are here to enrich the world, and you impoverish yourself if you forget that errand." Aside from the obvious societal benefits, there is much to be gained personally from working to achieve the greatest good for the greatest number of people. It has been richly rewarding for me to bring decades of experience as a banker to discussions on matters that have the power to transform that very industry. And I have been fortunate to work alongside other public servants who share the commitment to bettering the lives of the people we serve by working to ensure a strong financial system and a stable economy.

Thank you for the opportunity to be here today.