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From Community Banker to Central Banker--My Journey

Remarks by

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It is certainly a pleasure to be here at the University of Richmond and take part in the Robins Executive Speaker Series. Tonight I have been asked to share with you some of the memorable experiences and amazing opportunities that have shaped my journey from theater major to part-time drive-through teller 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 never planned to be a banker. I wanted to be an actress. I spent my college years pursuing a degree in dramatic art. 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 a man named Burt Harrison. Burt 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, which was later supplemented with industry schools and an MBA earned at night. 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.

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.

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 Federal Reserve Bank of Richmond. 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 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 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

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

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 usually made at an above-market rate.

In the Panic of 2008, liquidity needs were not confined to the banking system.[2] 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 nonbanks 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.

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[2] Kevin Warsh (2009), "The Panic of 2008," speech delivered at the Council of Institutional Investors 2009 Spring Meeting, Washington, April 6, www.federalreserve.gov/newsevents/speech/warsh20090406a.htm.

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, it was the image 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 the market for securities backed by loans to households and businesses, including loans for business equipment, inventory, insurance payments, business credit cards, and 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 still faces challenges, but I am convinced that the forceful actions of the Federal Reserve in 2008 helped prevent what clearly would 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 monetary policymaking as its primary role. 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 damp 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 three 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. 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 when I see the small business owners that I used to lend to, they tell me that they could not have survived the downturn without low rates.

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 Federal Reserve Bank of New York, and four of the remaining presidents on a rotating basis.[3]

In normal times, monetary policy is implemented through the purchase or sale of securities, which affects the supply of bank reserves and so has an effect on short-term interest rates. But monetary policy also works by influencing expectations of future short-term interest rates and thereby affecting longer-term rates and asset prices. Central bank communications can help individuals, businesses, and investors formulate their expectations for interest rates and inflation in the future and thus influence their actions today. Recognizing the importance of communications as a policy tool, the FOMC has

[3] For more information about the FOMC, see Board of Governors of the Federal Reserve System, "Federal Open Market Committee," webpage, www.federalreserve.gov/monetarypolicy/fomc.htm.

been engaged in a conversation about how we might better explain our framework for decisionmaking. In designing its communications, the FOMC faces complexities that make clear communication more difficult than you might think.

First, we need to explain the way we think about both parts of our dual mandate. Establishing a target for inflation is a tool used by many central banks to anchor inflation expectations. Central banks can establish such a target because, over the longer run, inflation is determined primarily by monetary policy. By contrast, the level of unemployment that would be considered to be consistent with maximum employment is influenced by factors other than monetary policy that may vary over time. The difficulty for the Federal Reserve lies in communicating clearly about the employment portion of the mandate without creating an impression that the Committee is either establishing an unemployment target or ignoring that part of the mandate altogether.

I do not believe that establishing an inflation target is inconsistent with a commitment to both parts of the dual mandate. On the contrary, it can help with thinking about and achieving both of our mandated objectives. For example, if having an explicit numerical target for inflation helps anchor inflation expectations over the longer run, then monetary policy will have greater flexibility to pursue the goal of maximum employment in the shorter term.

The second complexity in our communication has to do with the nature of Committee decisionmaking and the unusual voting structure of our Committee. For example, when preparing for a Committee meeting, I formulate my own outlook for the economy and opinions about the best policy path to follow. But I also rely on the Committee discussion to help me decide whether or not to support the policy favored by a majority of the voting members. As long as it is within a range of policies that I would view as appropriate, and I don't believe that the potential negative consequences outweigh the expected benefits, I will support the Committee decision. Now, consider the three different ways that I might communicate my thought process. I could make my own preferences known in a public speech such as this one. Four times a year, I submit my economic projections to be combined with those of all the participants in the FOMC and published as ranges in the Summary of Economic Projections, which is then used by the Chairman to discuss the views of the Committee at a press conference. And I have the opportunity to record a vote for or against any action taken or statement issued by the Committee itself. For Reserve Bank presidents who rotate votes, communication becomes more complicated when they don't have the opportunity to vote for or against a Committee action. I think it is hard to know which communications channel--individual statements of preference, ranges that include the unattributed opinions of voting and nonvoting participants, or Committee-approved statements--is most helpful for members of the public in formulating their own expectations of policy.

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 capability 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 public 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.[4]

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 members of the Board of Governors are nominated by the President and confirmed by the Senate. Each Reserve 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.[5] The Board of Governors oversees the

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[4] See Alberto Alesina (1988), "Macroeconomics and Politics," in Stanley Fischer, ed., *NBER Macroeconomics Annual*, vol. 3 (Cambridge, Mass.: MIT Press), pp. 13-62; Vittorio Grilli, Donato Masciandaro, and Guido Tabellini (1991), "Political and Monetary Institutions and Public Financial Policies in the Industrial Countries," *Economic Policy*, vol. 6 (13), pp. 342-92; Alex Cukierman (1992), *Central Bank Strategy, 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.

[5] Each Federal Reserve Bank's Class B and Class C directors--that is, the directors who are selected to represent the public--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).

Reserve Banks and is responsible for formulating bank regulations; supervising banks; and making decisions regarding lending, other than discount window lending, to depository institutions.[6]

The seven members of the Board of Governors serve 14-year terms, with one term ending in January of each even-numbered year. The terms run independently of the person serving in them, and members are often appointed, as I was, to fill the unexpired portion of a term. As has been the case for most of my time on the Board, there are currently two vacancies. A third vacancy would be created when my term ends this month. However, the law permits me to serve until someone is appointed and confirmed for my seat. I think it is important to have a full Board, in part because of the volume of work, but also because it is helpful to have a diversity of backgrounds and expertise to address the breadth and complexity of the issues that require Board action. For example, with the Fed at the center of the banking system, it is useful to have someone with banking knowledge. Currently, my community banking background provides practical insight, as the Federal Reserve is highly focused on strengthening the financial system without strangling the ability of smaller banks to serve small businesses and local communities.

So I am planning to stay on for a while. But as strongly as I believe in the importance of a full Board, I am hesitant to make an open-ended commitment to stay for as long as it takes to fill the current vacancies or until someone is nominated and confirmed for my seat. That said, I am still fully engaged every day with important

[6] For a fuller discussion of the responsibilities of the Board of Governors and the Federal Reserve Banks, see Board of Governors of the Federal Reserve System (2005), *The Federal Reserve System: Purposes and Functions*, 9th ed. (Washington: Board of Governors), www.federalreserve.gov/pf/pf.htm.

issues that are at the center of our economic recovery. It is gratifying to have such an opportunity and to work in this unique institution.

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 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 difficult 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

Now I'd like to turn 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 as though 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.

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 signed into law 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.