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FED GOVERNOR CHRISTOPHER WALLER: TRANSFORMING THE FED'S OPERATIONS FOR THE 21ST CENTURY

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WELCOME AND MODERATOR

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FEATURED SPEAKER

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WESSEL: Good afternoon. I'm David Wessel, director of the Hutchins Center on Fiscal and Monetary Policy in the Economic Studies program at Brookings. I'm very happy to welcome all here to the post Kevin Warsh confirmation hearing continuing the Fed party. Yeah. Yeah. Very happy to be joined by Fed Governor Chris Wallace.

Chris is an economist who join the St. Louis Fed as a research director in 2009, which is important given what he's gonna talk about today. He was nominated to the Fed Board by President Trump in 2020 and was confirmed 48 to 47 for a term that extends to 2030. He was paired with Judy Shelton, who somehow never made it to the Fed. But relevant for today, Governor Waller is the oversight governor for reserve bank operations and payment systems.

Now, as many of you know, the Fed is now in the blackout period. He's not gonna talk about monetary policy today. And if you ask a question about monetary policy, I will rule you out of order. If you want to know what he thinks, you can read the speech he gave on Friday. I'll give you the short version. It depends. If the Strait of Hormuz opens, trade flows return somewhat to normal, underlying inflation continues to move towards 2%, he'd be cautious about rate cuts now and more inclined toward rate cuts later, support the labor market later this year. But if, the longer energy prices remain elevated and the Strait of Hormuz is constrained, that may mean maintaining interest rates at the current target level if interest, if inflation risks outweigh those to the labor market. He took several more minutes to say that, but that's what his point was.

But what's relevant to today is that when Congress created the Federal Reserve in 1913, it established a Federal Reserve Board in Washington and 12 regional Federal Reserve banks. Now, there've been some changes over the decades, but that unusual structure remains in place, and in my opinion, reinforces the Fed's independence from elected politicians. The structure balances the power of the seven presidentially appointed Fed governors in Washington with the presidents of the 12 Reserve banks who are appointed by their private sector board's director, subject to approval of the board in Washington.

But I think people don't appreciate how much of the Fed's operations, including payments, processing, and infrastructure, are actually conducted by the Reserve banks, which have a collective budget of $5.9 billion, which is more than five times that of the board in Washington. And that more than 85% of the Federal Reserve system's current more or less 24,000 employees work at the regional banks.

So Governor Waller's today is gonna talk about the operations of the Fed. I'll ask him some questions afterwards and then we'll entertain your questions. So the podium's yours.

WALLER: Well, thank you David, and thank you to Brookings for having me speak today. Last summer I gave a speech on the Fed's balance sheet, which I likened to going to the dentist for the audience. So today, speaking about operations is probably gonna feel like getting your tongue pierced.

Whenever anyone hears the words Federal Reserve, they immediately think about monetary policy and the Federal Open Market Committee or FOMC, setting the federal funds rate. This is obviously, there is obviously tremendous media attention on those policy decisions as there should be because they affect US households and businesses and financial markets around the world. But the FOMC only meets 16 days a year to set monetary policy. So what are we doing at the Fed the rest of the time?

The answer to that question is that we run a large and complex organization across 12 Federal Reserve districts with a very heavy operations focus. So today I want to talk about how we meet these operational responsibilities to give you a better understanding of the structure of the Fed and what we do each day.

As I will explain, there were and remain good reasons for the Fed's decentralized structure, which is mandated under the 1913 Federal Reserve Act. It is an important enabler in carrying out our many vital responsibilities, which affect virtually everyone in every corner of America. But that doesn't mean the Fed's operation should not change to reflect a changing world as the board member responsible for leading the oversight of Federal Reserve operations on behalf of my colleagues.

I believe the Federal Reserve needs to be continuously oriented toward modernize, modernizing how it operates, reducing costs, more effectively managing risk, and delivering the best possible value to the American taxpayer. And that has been my objective since I became the, a member of the Board of Governors, the member of the Board of Governors responsible for Reserve bank oversight.

To explain why that matters and what it has meant in practice. I will start with a brief overview of the structure of the Fed and describe how its operations have evolved over time, including over the last few years under my direction. I will then address two questions that I believe are critical for thinking about how the Federal Reserve should organize its work in the 21st century.

First, which activities does the Fed do are intrinsically local and conducted for the benefit of an individual reserve bank district? Second, which activities are conducted on behalf of the Federal Reserve system as a whole with attendant opportunities to exploit specialization, economies of scope, and economies of scale. In short, what needs to be done at a Reserve bank and what can be done more efficiently anywhere else?

So to begin with a quick orientation, the Federal Reserve system is composed of the Board of Governors in Washington, DC, the 12 regional Reserve banks located across the country and the Federal Open Market Committee. In this speech, I will focus solely on the Reserve banks and not the board or the FOMC.

Now all told there are approximately 20,000 employees across the 12 banks with the vast majority of these employees focused on operations, implementing market operations, performing fiscal agent activities for the US Treasury and running the Fed's payment systems along with the support and overhead functions like information technology or IT, human resources or HR, finance, and procurement that go along with operating 12 Reserve banks.

Now, the Federal Reserve, as most of you know was created as a compromise between those who recognized the need for a US central bank and those who were suspicious of concentrating such power in Washington or New York. The result was a decentralized system of 12 regional Reserve banks with boards of directors drawn from the local business community, although ultimate oversight in many respects resides with federally appointed officials in Washington from the beginning.

Each Reserve bank was self, was a self-contained organization. Each provided services including check processing, wire transaction, and cash distribution to the commercial banks in the district that had elected to be members with membership.

In the Federal Reserve, a bank reserve received certain benefits and incurred certain obligations, notably to submit to regular examinations by the Reserve bank in their district. Now due to branching restrictions, at the time a member bank was in that district and that district only. In addition to these services and oversight, each Reserve bank also collected local economic information and data, and did analysis of the local economy. Initially the discount rate at each bank was set locally to reflect local economic and credit conditions.

So at the beginning, everything a, a Reserve bank did was local. No national functions were performed. This decentralized app approach made more sense when the economy and the banking system were much more regional in nature. But as financing the economy became more national in scope, changes were needed. Statutory changes were made by Congress to the Federal Reserve Act in 1935, under which the presidents of the Reserve banks took on a national role in setting monetary policy via the Federal Open Market Committee. The discount rate was also nationalized so that all banks charge the same rate for lending to local banks. But after these changes, most Reserve bank operations remained local while monetary policy was conducted at the national level. Bank supervision, payment system, activities, and most other functions at Reserve banks remained focused on serving the district.

Now also characteristic of the early years were Reserve banks that had large number of workers engaged were at that time highly manual and labor intensive processes. Such work included processing paper checks, managing distribution of coins and currency, discounting or providing commercial banks liquidity against a variety of instruments, often taking physical custody of this collateral to assure a security interest in managing US treasuries.

Now, in this era, Reserve banks operated under a clear bank first, system second mindset. In rare instances, that required more of a system approach, for example, managing transactions between the banks and different districts, this coordination occurred through occasional meetings of the Conference of Presidents, an ad hoc group composed of the 12 Reserve bank presidents. A deeply embedded and longstanding common understanding of the decisionmaking process for the Conference of Presidents was that the group could not force a bank to do anything. Everything had to be resolved by consensus. This decisionmaking process was consistent with the view that the private Reserve banks were essentially independent private sector and governed by the local boards of directors in the district, and thus had the op, the freedom to operate as they saw fit within the broad confines of the Federal Reserve Act.

Now over the decades, as technology changed and US financial sector regulation evolved, the external environment began to shift in very important ways as financial transactions became increasingly digital. In the 1960s, the Fed developed new nationwide electronic payment capabilities. Congress ended branching restrictions. In the '80s, regulatory changes allowed national banking organizations to emerge, a phenomenon which broke the one-to-one connection between a Reserve bank and its member commercial banks. Commercial banks with operations across multiple districts were not enthralled with needing to maintain relationships with multiple Reserve banks, each of which offered slightly different mixes of services and slightly different pricing on those services.

In 1981, a critical decision by Congress directed the Fed to recover the cost associated with its payment services through fees levied on both member and non-member banks, a requirement intended to level the playing field between the reserve banks and private sector providers of payment services. By the mid '90s, the reserve banks had begun consolidating their payment services. In response to these developments, some key services were starting to be centralized in specific districts with the establishment of what were called at the time product offices to provide more uniform services to banks nationally. Over this same period, check volumes began to drop precipitously as digital payments gained steam, and the private sector took market share from the Fed in check processing.

The terrorist attacks on September 11th, 2001 underscored the vulnerability of a payment system that still relied on leased airplanes to fly paper checks around the nation. The digitization of paper checks followed the Check 21 Act in the early 2000s and led to a further reduction in the processing of physical checks. Now the result is that the Reserve bank saw a significant reduction in operations and employment at their branches, to the point where they closed and began selling some buildings, even at head offices. The labor intensive payments work reduced manpower needs and employment. The era when most head offices and many branches ran three shifts of check processing each business day came to an end.

On another front as information technology advanced rapidly in the 1980s and 1990s. The Reserve banks realized there were economies of scale to be achieved by centralizing information technology infrastructure into one location that would operate on behalf of the entire Federal Reserve system. It made no sense for each Reserve bank to construct, operate, and maintain its own mainframe or later server farms.

Thus in the '90s, the Reserve banks created Federal Reserve Automation Services or FRAS, now referred to internally as national IT. To build and maintain a single common IT infrastructure, an FRAS director was named to manage this consolidated infrastructure, but most decision authority remained at the individual Reserve banks.

More recently in 2021, Fed financial services were consolidated into a single payment service line with its own chief payments executive who would oversee payment operations across the 12 Reserve banks. With the appointment of a chief payments executive and the increased authority of the chief information officer, the move was moving into a world where its arguably most critical operational responsibilities were starting to be managed at the system rather than the individual bank level.

Another example of the Fed's gradual move towards centralization is in its role as fiscal agent for the US Treasury handling payments and securities issuance, auctions and redemptions, as well as providing other banking services to the Treasury. Most of this work as fiscal agent was spread around all 12 Reserve banks. But in 2014, Treasury's Bureau of the Fiscal service began to largely consolidate fiscal agency work in St. Louis, Kansas City and Cleveland. While the Federal Reserve Bank of New York continued to manage US Treasury auctions and certain other activities that required direct market interactions.

Now despite this gradual movement towards more centralization and payments, iT official and fiscal agency, many of the other support functions, including HR, procurement, and finance, still ran more or less separately at each of the 12 Reserve banks. In my view, we have reached a point where we need to exploit the efficiency and risk reduction benefits of standardizing and probably centrally leading all of these, of these functions. I believe there is significant opportunity for more improvement.

So at this point I will now return to the initial two questions I posed. What Reserve bank functions must be done locally because they serve and must be tailored to the needs of a specific district, and which of the functions can be done anywhere to benefit the entire Federal Reserve system?

Let's start with what activities are inherently district oriented, consistent with the original intent of the Federal Reserve Act. Namely, if the US should have a central bank that reflects the needs of different regions and not be solely connected to Wall Street or Washington DC, these are the activities where geography still matters.

Now, clearly, some of the work that has always been carried out by different districts in different ways remains appropriately local in approach and substance. Today I personally see no reason to reduce the number of reserve banks or alter their geographic boundaries. Each bank president still has an independent voice at the FOMC on the appropriate course of monetary policy, and that should continue.

Each president's views are shaped by the research of the bank's economist, its regional experts, the input from the bank's board of directors and the president's interactions with business leaders in the district. Each bank president contributes that perspective to the discussion in Washington with his or her colleagues, which generates a view of the economy as a whole at the national level, and thus what direction policy should take now.

In addition to contributing to the development of monetary policy, each president engages with the business, financial, and non-profit communities to better understand local economic issues and to position the bank to serve as a convener of various interest groups to address local economic issues such as labor force development, financial inclusion, and issues related to rural areas.

These activities are enormously valuable to carrying out the Fed's mission and they should continue. Each Reserve bank also still conducts supervision of state member banks and bank holding companies ,relying on the regional knowledge and expertise of supervisors based in the district and on regional industries and economic trends.

Local, local presence and supervision will continue to be important. This local expertise is also important when the Reserve bank serves as lender to depository institutions through the discount window. Market operations are concentrated in New York in proximity to the securities dealers who facilitate the implementation of monetary policy through open market operations.

But now let's turn to a very different class of activities that are important to the system's overall operations, and for which geography does not matter. These functions are increasingly platform based, technology driven, and scale intensive. The list includes HR systems, payroll and benefits administration, finance and accounting, procurement and vendor management, as well as the payments IT and fiscal agency work. That's the stuff I deal with every day. It's not setting interest rates.

These functions are not delivered better or more efficiently with geographic dispersion, nor are they unique to a district. They improve with integration scale and standardization. With that comes lower operating cost, risk reduction, and greater savings for the American taxpayer. With these functions, our philosophy must be system first, bank second. This is the message I have been delivering to the Reserve banks the last three years in terms of how our operations need to be organized and managed.

Now you may be asking, why am I bringing this up now? Haven't the Reserve banks consistently evolved to changes in the environment around them, as I described earlier? Why can't this evolution just continue organically? The answer is, I do not believe that this traditional approach will meet the moment and the needs of the US economy for several reasons.

First, the external environment has changed. Technology cycles are faster and far more disruptive. Artificial intelligence is a coming storm that threatens to alter and I believe improve all organizations. The pace of technological change today means that the Fed does not have the time to sit back and ruminate about changes for months and years on end if we are gonna ride this wave and not be drowned by it. We need greater agility to capture efficiencies and manage risk, such as cyber, cybersecurity and incorporating AI into our system processes.

Second, consolidating functions makes sense for competing in talent markets that are increasingly national and sometimes global. We will achieve greater efficiency through consolidation and also attract the best talent in finance, HR, and procurement by offering people the opportunity to work for a national organization with greater responsibility and impact.

Finally, benchmarking against the private sector is absolutely unavoidable. We are significantly off market on IT costs largely because of localized development of application and procurement of software, and because of the complexity of our offerings across the banks. We are not exploiting the available economies of scale or risk reduction benefits across a wide range of areas. Other large organizations have long faced financial pressure to standardize, centralize, and in some cases outsource. One critical benefit we receive from the Reserve Bank boards of directors is having private CEOs among their members. The ability of these directors to point out where our costs are out of line and how we might improve both efficiency and performance as we consider the future framework for Federal Reserve bank operations.

One thing is clear, we are not going to return to a world where everything is done locally. So looking forward, I believe that two models for the further evolution of the Fed's operational footprint are worth considering. The first is standardization within centralized system leadership. Under this model, the current physical put footprint of the Reserve banks remains largely intact, but each major support function-- IT, HR, finance, procurement, vendor management, facilities --is placed under a single senior leader who runs that function within a Reserve bank for the entire system. That leader sets standards, makes enterprise-wide decisions, manages vendors and is accountable for performance across all 12 districts. Local staff obviously remain in place, but operate within a unified framework rather than 12 separate ones.

System function leaders would operate within the existing Federal reserve governance structure, reporting through Reserve bank presidents and local boards with the Board of Governors providing ultimate oversight. This is not a reorganization that centralizes authority in Washington. I wanna make that clear. It's still in a Reserve bank. It's not at the Board of Governors. It is one that empowers, assists them to act as one enterprise while preserving the governance architecture the Federal Reserve Act established. This model captures much of standardization, lower cost, reduce risk, and greater consistency, without requiring the more difficult work of physical consolidation.

Now, the second model goes for further. If it can be done anywhere, it can be done anywhere. It doesn't have to be done in a single Reserve bank. If an outside consultant were asked to design the Fed's operating system, just the operating system from scratch, I believe it'd be a lot closer to this second model. It takes everything in the first model and adds physical consolidation across key functions, or placing stuff in low cost appropriate talent cities. HR could be run out of one of the Reserve banks, or you could put it in Des Moines, Iowa. It doesn't have to be in a Reserve bank. Functions that do not need to be local, HR administration, payroll finance, and accounting procurement-- and you should have this all memorized now for the test at the end-- you know are concentrated in small number of operation centers located in lower cost cities, or those that have a comparative labor skills advantage. Outsourcing certain activities should occur if the opportunity for cost savings warrants it. Again, we might want to get rid of things that we do to let the private sector do it. The specialized work that generally requires district presence remains in the districts. Everything else just follows the economics. The system gains not only the benefits of unified leadership in standardized processes, but also the full economies of consolidated facilities and labor markets.

As with the first model, the formal legal structure of the Federal Reserve remains unchanged. System functional leaders report through Reserve bank presidents and local boards with the Board of Governors providing oversight consistent with its statutory rule. What must change for this approach to succeed is not the Fed's structure, but its long held expectation that every significant operational decision requires consensus across 12 different institutions. The second model is the one that large, well run organizations, both public and private sector, have largely converged on, and it represents the more complete realization of what operational modernization can achieve.

Now, either model represents a meaningful step forward, but it should be said plainly the first is a way point, not a destination. And the full benefits in cost and resilience and hybrid security and in talent are probably realized only under the second approach. An obvious implication of this second model is that some Reserve banks may face lower levels of employment in the future as happened with the closing of branches when check clearing went away. I believe we will need to rethink the physical footprint of the Reserve banks going forward.

Both models also require a shift in how operational decisions are made. A system in which senior leaders run enterprise-wide functions requires genuine delegation of authority, more authority than most first most Reserve bank first vice presidents exercise today. Decisions about HR administration, IT, blah blah, all the ones I have already named, these standards need to be made at the system level and not decided district by district. That requires not just delegation of authority, but a genuine shift away from consensus based operational decisionmaking. The decisionmaking model based on debate and consensus that serves us well in the FOMC boardroom when developing monetary policy is not ideal when it comes to running our operations. A leader of a system function who must secure agreement from 12 quasi independent institutions before acting cannot be an effective leader. I believe we need a key shift in our approach to governance. We need to distinguish between decisions that do need consensus for effective change, and those where consensus becomes a hindrance to effective change.

The punchline of this speech is that we do, is we need to do more to centralize our operations into national lines of business and move away from having individual Reserve banks managing operational infrastructure from a bank mindset instead of a system mindset. We need to have strong leadership and governance of these national business lines. And this does not mean it can always be accomplished through a consensus of 12 Reserve bank presidents. Inefficient governance and overlapping lines of authority lead to cost, inefficiencies, and unnecessary risk. On the other hand, I believe we have an opportunity to leverage scale and our talent across the system to produce better outcomes for US households and businesses.

Decentralization is a strength of the design of the Federal Reserve, but only when it reflects the genuine strengths of regional differentiation, not fragmentation for its own sake. Autonomy is a virtue, but not when it produces costly duplication that serves no one. We owe this to the American people we serve. Tradition deserves respect, but not when it stands in the way of necessary change.

To leave you with a final takeaway, operational excellence at the Federal Reserve depends on our willingness to standardize what should be standardized and centralize what should be centralized so that we can strengthen what's what must remain to distinctly regional to meet the needs of a large and heterogeneous country. This is an important conversation and I appreciate the constructive engagement of all, and thank you for bearing through the tongue piercing.

WESSEL: I am, I'm just trying to imagine the political cartoon that has a picture of you with a tongue piercing. I look forward to seeing that. And I can see what the staff of the Reserve Banks is gonna be giving you for Christmas. Might be piercing other places too.

I wanna start, you made a point, but I want to drill down on it a little bit about what you're not proposing. So we have a rather unusual structure that the fact that the Reserve banks are not government entities completely, their presidents are not government employees. You voted when you were recently on the board to extend their terms for another five years, which I didn't even know they had five year terms until that happened.

But why is it important to have 12 Reserve banks? And have independence in their appointments and stuff. What's the point of that? Why is, why don't you wanna change that?

WALLER: Yeah, so I genuinely believe that the Federal Reserve Act, where they created this system was genius. There was a time where you worried about New York Wall Street running the central bank or being completely politicized, being in DC. So the founders had this idea, get it out away from DC and Washington and let them have their own decisionmaking authority over many of the things I described. At the time it all made sense. And also in terms of thinking about policy, you bring this information from around the country to DC. That's what that was the idea. And I agree with that structured to, to this day.

I don't see any reason to reduce the number of Reserve banks or change their boundaries. I hope the speech explained why. Changing the boundaries just means one Reserve bank's gonna do it or the other, you're not gaining anything, okay. And a large part of what we do, I said geography doesn't matter. So moving a Reserve bank around doesn't gain you anything. It's all done at some national level. So I don't see any big gain of trying to do any of this. People have floated around the idea of moving Reserve banks. I just tried to explain it doesn't matter for any of our operational stuff. You're gonna wanna reduce the number of Reserve banks, what you're really doing is saying, we don't want as many FOMC members and then that reduces the impact and the influence from the rest of the country. I don't think that's a good idea either.

WESSEL: And if someone said to you as a governor, we'd like you to consider firing some of the Reserve bank presidents 'cause we don't like their views on interest rates, what would you say?

WALLER: Well, that's not the design of the system

WESSEL: You would be against that.

WALLER: I would generally absolutely be against it.

WESSEL: All right. So. There's a lot going on in the world today. Why now make a big deal out of this consolidation of IT, HR, procurement, and all the other things?

WALLER: Well, I guess the thing is when I took over in the fall of '22, and I had also been in the Fed for a long time and had always saw issues with the way IT was done, structured, managed, cost, and it always made sense to me that something needed to be done with national IT. And then when I took over managing Reserve banks, a lot of stories that are history and don't want to get into, but it became clear to me that we just weren't organizing and running these things properly from, just from a business perspective, not from a Fed, not from monetary policy, but how you would run things from a business perspective.

And so I had, I ran into this problem. We were doing all these things that were national in scope, but still running 'em as if they were still at the bank level. And that's when I told all the Reserve banks starting back in '22, '23, we have to move from a bank first mindset to a system first mindset. And with that thinking, you think about how we do things very differently than if you're just worried about my bank, my people, what I control. And that is not the way a Reserve bank should be thinking about what it does on operations.

WESSEL: So does the board of Governors have the capacity though, to be running all this stuff?

WALLER: We're not running it. I just oversee it.

WESSEL: But you're proposing a change where you say it's gonna be national and they might not be at a Reserve bank and they're gonna report through the presidents to the, to somebody who's at on the board staff. So in your world, the board ends up with--

WALLER: Well, I, I have oversight right now.

WESSEL: Right.

WALLER: So I'm not changing anything. I'm just saying that how you organize the provision of these services is not, the way we're doing it now is not the way we need to do it going forward. We've made progress on some, we started moving IT, payments more into these national business lines. We have done that, but we didn't change the governance structure around it in a way that I felt was the way.

WESSEL: So the governance structure is who's in charge of these things?

WALLER: The 12 presidents.

WESSEL: But you said that they're gonna report to somebody centrally.

WALLER: Well, I have oversight, but we typically, we leave the decisions to them to how to do this. So that's, but when they were making decisions, their focus was on their individual bank and not, how do you make the thing better for the system? And that's just a mindset change. It's not changing how many presidents, however, it's just, they have to get away from thinking about everything we do. How does it help my bank? As opposed to how does it help the system to do what we do better?

WESSEL: And have you thought if you went to your second, more dramatic change. Do you have any idea of how much money this is gonna save?

WALLER: Oh, I have no idea. We could look into things. You, if you're gonna think about a back office function like a HR, why would you stick it in high cost cities like New York or San Francisco?

And it makes no sense for the US taxpayer to get the same product and pay a lot more in terms of the wages, unless there was some particular label, labor skillset that said, pick that location.

WESSEL: Right. You think we should move the Board of Governors to a lower cost city?

WALLER: Maybe we don't get paid that well, so.

WESSEL: What, I'm interested, so this is a challenge that all leaders of organizations face. The world is changing. People, their skills that they had may not make, be obsolete. Organizational change is hard when you, if you look at, if you think about the employees of the Federal Reserve System, all these people are doing HR, finance, IT, and procurement.

How do you, what's your philosophy of how you lead this kind of organizational change? Do you just tell them all, we're redesigning your jobs, you can apply or leave, or do you bring them along? When you, what's your philosophy of that? What have you learned about that?

WALLER: Well, there's a lot of things where, we're dealing with AI now. We're introducing AI throughout the Federal Reserve. I gave a speech two months ago on what the Fed is doing. The critical thing is I try to tell everybody, AI is a tool. That's all it is. It's a tool to help you do your job better. We are going to invest in you to learn this tool to help you make better. We're not gonna say, oh, go off on the weekend and figure out how to do it yourself. We're gonna embed it into your actual performance plan to make sure that you have the incentive to use this tool in the appropriate way, since we're making the investment to put this tool available for you.

So that's how I handle something like AI. I'm not sitting there going, wow, this is great, we can go fire all these people. That's not what it is. Now, the obvious thing is like coding. If you can use Claude to start doing a lot of your coding, your coders can get stuff done faster and more efficiently and do more work. Maybe you don't need quite as many coders as used to, but that's again, that's efficiency cost that helps the US taxpayer. It's more that we give back to the taxpayer.

WESSEL: But some, you're talking about moving some people from high-cost cities to low-cost cities. You're gonna give them a choice, stay where you are, and lose your job or move to Des Moines. When you, what, what message do you give to the people who've been working to the Fed?

WALLER: It's hard to justify a lot of expensive labor just because you're in a high-cost city. Now, Treasury did this in 2014. They took all the operations that were in high-cost cities and they said, we're moving. Sorry. You can either go to St. Louis, you can go to Cleveland, you can go to Kansas City, but you're not staying in Boston. You're not staying in San Francisco. Those things are gone. So, it's just, at the end of the day, you just can't justify spending lots of money just because, well, I like living in Boston and working for the Fed.

WESSEL: And you envision the Fed outsourcing more to the private sector?

WALLER: Could. Constantly thinking about what we could do. Give you a simple example. Every Reserve bank outsourced their cafeteria years ago. We don't manage cafeterias, we don't do anything. We don't have any employees that work in the cafeteria. Why is the cafeteria the only thing that you might wanna look at? You could do some other things, right?

WESSEL: Like what?

WALLER: You could, well, one thing would be just cash vaults. This is one thing you could say is like, and I think this is an archaic idea that needs to be thought rethought. Every home office, every major Reserve banks has a cash vault in the basement. Why? Why is the vault there? Why can't the vault be somewhere else? Why is it right in the middle of the downtown of an area? Should be put somewhere else where they might go. Put it in the airport; you got the airport security, put your security. Maybe it's more easier for trucks to get in and out than trying to fight through downtown traffic to get in to put money in and take money in and out of a vault.

These are ideas. I'm not saying we're do it, but just start thinking about why. And then if you did that, how much law enforcement do you need in the Reserve banks if there's not cash in the building? I'm just thinking about why are we organized the way we do and why are we still doing things just because we did it this way 110 years ago?

WESSEL: Yeah. Must be some capital costs moving cash vaults from one place to another.

WALLER: Well, yeah, it could be. Or we just rent--

WESSEL: Why do we have so much cash anyways. Why?

WALLER: Don't ask me. Ask the American public. I just provide cash on demand. They're demanding it. I give it to 'em. Go ask them. I, I don't use any, but--

WESSEL: You said something about rethinking the physical footprint of the Reserve banks. What are you talking about?

WALLER: Well, there's, it's back to this question that, when we check clearing went away, a lot of the branches had buildings that were just, there was no purpose for 'em anymore. And we sold those buildings off. They didn't, the branch didn't go away. They just got put into a smaller footprint.

That's, this is what I mean by a smaller footprint. We still, we never did it with any of the head home office buildings. And they lost a lot of employment as well, but we never did anything. So you can either say, we're gonna lease out the space and get into commercial real estate business, which is not what we should be doing. Or you rethink, do you need to still be in the building if you're not gonna have more people coming in? That's what I meant by, I'm not suggesting we're gonna go do anything, but these are just things you gotta think about once you realize that. Why are we in these?

WESSEL: But didn't the board decide to give up lease space, build its own building? Why should, why is it better for the board to do that than the Reserve banks?

WALLER: Well, that's 'cause we had the employees, these banks don't have the employees.

WESSEL: I see.

WALLER: That's the big difference. We're not saying they have a lot of lease space. St. Louis, I'm gonna speak for St. Louis. Sorry for St. Louis, but St. Louis is a six story building and they're leasing like four stories from a building next door. Okay. There's a building where you need actually to change the physical footprint. They need a bigger building. Right. It's not like getting--

WESSEL: But that's unusual.

WALLER: That's unusual, but that's just the nature of St. Louis.

WESSEL: So, in preparation as I, I got a text from a reporter who said, are you a little bit, is it a good idea for you to be talking about restructuring the Fed at a time when there's some people who talk about regime change and the, a lot of criticism of the Fed from the president and the Treasury? Aren't you opening up the Fed to a more wholesale reorganization than you anticipate by just doing--

WALLER: Well, this is about operations. This is the stuff we do, and I'm trying to figure out how do we do it cheaper and easier, more efficiently to save money for the US taxpayer? Who's gonna stop me from doing that?

WESSEL: Well,

WALLER: Or wants to stop me from doing that?

WESSEL: I can think of some people, but anyways. So the argument I hear from the Reserve banks, with which I know you're familiar, is that without a certain set of responsibilities and a certain core staff the Reserve Banks will be like the Economic Studies department at Brookings, a president and a dozen of the world's best economists. And that'll make it hard for them to actually attract good directors and be viable, vibrant institutions. I know you've heard this argument, so what is your answer when the president say that?

WALLER: I say when people get selected to be presidents. I don't think most of 'em said, I want to come in and run HR. I don't think I've met a single, in my years of helping pick presidents for these, I don't ever heard anybody say that. They want to come in, they wanna do policy, they want to be out there, they wanna be meeting with their community. Nobody's saying, geez, I want to come in and do employee healthcare benefit pricing. That's not what they want to come in and do the job for.

So then the question is, why is that something you're being forced to do instead of doing what's important for you to do?

WESSEL: So when the president asked you to be a governor of the Federal Reserve, did he tell you, you got to worry about Reserve bank operations, IT and HR?

WALLER: If you told me that this is what I would've been doing when I joined the Fed in 2009, I'd still be a college professor.

WESSEL: All right. We have time for some questions. I'm gonna take two or three. I wanna remind people that we're not talking about monetary policy.

WALLER: Yup, forget it.

WESSEL: You can try, but it's not gonna work. So wait for the mic, stand up and tell us who you are. I'm gonna take two or three questions.

AUDIENCE QUESTION: Jonathan Pingle. Just, Chair Powell had mentioned in the, discussions of broader workforce reductions across the system. I was just curious how you think this dovetails with some of that effort.

WALLER: Well, that--

WESSEL: Let's take a couple.

WALLER: Sorry.

WESSEL: Okay. Wanna take--

AUDIENCE QUESTION: Thank you, Governor Waller. Pedro da Costa from MNI. My question is, do you envision the regional banks' research, macro research function being curtailed in favor of a more regional focus? Thank you.

WESSEL: Alright, take those two.

WALLER: Okay. So, on the 10% head count reduction that Jay did, you know the banks have been working very extremely well in working on that, coming up with a plan, and doing this sensibly and strategically, not just wholesale going around whacking 10% of the, that's not happening. And we're doing it over to a two year period, so that's already going on.

What I'm saying is there is possibility in some areas that could be bigger than 10%. That doesn't mean those people don't get repurposed for something else more valuable. That was back to David's question earlier, which is, sometimes people are doing stuff that if you free them up, you could do more stuff. Lemme give you a simple example. If we were to do some IT savings in terms of cost or bodies, but then we wanna say, now we've got the funds and the talent to go rebuild all or redo all the tech debt we have, rewriting software in all of our older systems, we now have the people and the talent. Before we couldn't do it 'cause we just didn't have the money or the talent. Now we do. So it doesn't necessarily mean we're going to reduce, but we can reallocate things to where there's a more important and right now obvious need for trying to think about redoing software.

WESSEL: Lemme just make sure everybody, when you say tech debt, you mean old software that needs to be rewritten--

WALLER: Old software needs to be rewritten, brought up to standards, old languages that people don't even remember how to code in anymore. We wanna move it to more modern tech stacks in terms of how we operate payments.

WESSEL: So the other question was, do you wanna neuter the macro research at the banks in favor of regional research?

WALLER: No. I think each Reserve bank, I said each Reserve bank president is part of the FOMC and makes policy decisions. They want to have their own research staff to help them guide whatever the questions are that they need, or also things that are unique to their district. I see absolutely no reason to try to say, well, you might as well say let's take 10 states and create one university for all 10. You could do that. Why? And just, I don't really see a big advantage of it. So I'm, having run a research department in a regional Fed, I'm all for keeping it just the way it is.

WESSEL: How worried are you about the cyber risk to the Fed's operating systems?

WALLER: I worry about, that's the stuff that keeps me up at night. And then it's just, you never know. And particularly I'm the over, in addition to overseeing the Reserve banks, I oversee the U.S. payment system. I'm the oversight governor for the U.S. payment. If something happens and shuts down the Fed, the payment system, you know the economy will come to a complete stop. No transactions of any kind. No, nothing. So yeah, any cyber attacks, it keeps me up at night.

WESSEL: So how does your proposal deal with that, minimizing that risk?

WALLER: Because if you thought about trying to have cybersecurity done, each individual bank managed by the local IT and local print, it's a mistake.

This is something that has to be done at scale, broad. Broad knowledge, broad infrastructure, easy access for one group that makes decisions to spread that out through the system. That's a critical thing, and that's what I mean. This stuff is no longer bank centric in any way, shape or form.

All right. Everybody's ready to get back to their real life.

WESSEL: Well, let me just, I wonder if you could talk a little bit about. I, honestly, I don't remember what you said in your AI speech about how the Fed is using AI. As I understand what you're saying here, this is a precursor. This has, this is what you need to do now based on existing technologies. But if you look forward a couple years, how do you see AI affecting this part of the Fed's operations?

WALLER: Well, I think it's, like I said, I am, this is my view and other people I've different view from all I've seen in my life when it comes to technological change. These things are tools. They're not new human beings or consciousness who take, literally eat us and take over. We had desktops. I remember when the internet came out and I'd go visit the regional Feds and like, oh God, we can't have the internet in the building. That was the fear. But over time you learn how to adapt to use these tools to make the organization better. So that's how I think about AI. It's gonna be a tool that we're use-- that we can do a lot more stuff much faster, much more efficiently, and allow people to be creative. That to me is the big thing. Be creative so then we can then use these tools to do more stuff.

WESSEL: Have you used, how do you use AI yourself?

WALLER: Typically? I'm trying to see if it can write a speech for me.

WESSEL: Yeah. How's it doing?

WALLER: It does pretty well for about the first, eh, 800 words and it always goes off the rail some more.

WESSEL: Well, maybe you should--

WALLER: Or a lot of my early ones my speeches sounded like speeches Janet would give.

WESSEL: Is that, I'm not, I'm not going there.

WALLER: It sounds just like a speech Janet would-- but that's what it was trained on early on.

WESSEL: Okay. I'm gonna leave that one. Any other questions? If not--

WALLER: There's one in the back.

WESSEL: Oh, I'm sorry. Thank you.

AUDIENCE QUESTION: Hi Anda Greeny. I'm a small business owner here in DC. I'm curious, do you see a role for the Fed in payment processing for small businesses? Someone buys something on my website and needs to pay me $300 and through Shopify payments I pay $10 in credit card processing fees. And that's a cost to me or it's a cost to the consumer, depending on how you look at it.

WALLER: Yeah, the world of payments is, I personally find it fascinating. That's the one part of coming out of academia into this job that I really enjoy a lot.

We have our Fed payment systems. We have Fed Now, which is real time instant settlement, but banks are the only, you have to go through a bank to access it. We have Fed Wire, which is large value trend, but everything we do in our payment system has to, is connected to the banking system. We don't have any payment that I'm aware-- somebody can yell at me if I say this wrong, but we don't have anything where non-banks can access our payment rails. That's not in place yet.

Now, that doesn't mean down the road, future legislation, you couldn't, Congress couldn't say a payment processor or a fintech, we should be able to access Fed rails. But they can't now by law. So that's something down in the future. So you're still gonna have to go work with your bank or fintech or whoever to get through our payment rails. There are other payment rolls besides ours out there.

WESSEL: One of the things you mentioned was, I can't find in your speech, but that Congress required the Fed recover cost, the cost of these things. So is, does that make Fed Now more expensive and make it more difficult to spread it? Because you have, you can't say, we're, we invested and we're gonna get the return overtime.

WALLER: Yeah, that's the thing is, you know, we have these payment systems and we do have to recover costs. And we do.

WESSEL: Right. But,

WALLER: And Fed Now is a new thing and there's a time horizon in which we will have to start showing whether we are recouping that. Some of this down the road will be, more transactions will go off of ACH onto Fed Now, more transactions will go off Fed Wire onto Fed Now, but that's just cannibalizing traffic from other systems. So what may happen down the road, I'm not saying when, I'll be long gone before that happens, but you might consolidate these different payment tech stacks into one tech stack so that everything goes through Fed Now. It's our modern tech stack in terms of code.

WESSEL: And do you think that the blockchain has the potential to lower these transaction costs and lower the $10 this guy pays for a hundred.

WALLER: I always try to make this point that blockchain is just a data management tool. That's all. It's a, that's it.

WESSEL: But you can have easier realtime statement so--

WALLER: Yeah, so it's a database management tool where you can record history and transactions. But then you just have to have the other technologies that allow you to connect to it, trade on it. It's more than just a blockchain you have to do. You have to have tokenization, you have to have smart contracts, you have to have all these other technologies in place to make that thing useful.

WESSEL: But I guess what I'm asking is the combination of AI and blockchain going to have the potential to lower the transaction costs of payments in our economy in the next three to four years.

WALLER: Mainly what blockchains and spark contracts is allows you 24 7.

WESSEL: Instant sell.

WALLER: Instant sell, but you can do that on Fed Now. Yeah, if your bank is connected and works through, you can do 24 7 payments right now on Fed Now.

WESSEL: So why isn't Fed Now grown more, more rapidly?

WALLER: It's just getting banks. I've always had this kind of joke whenever it came out. Everybody wants to get their money instantly. Nobody wants to necessarily send it instantly.

Both sides of that have to happen to have real time payments on spend now. People want to send it quickly and they wanna receive it. It's the sending part. People are always willing to, like, I'm in no real rush to get that payment out today. I see.

So anyway that's, I think that's the challenge is you gotta get, build the cases for which people want to send their money fast. Everybody wants to receive their money fast. I wanna be paid every day by the Fed. They don't let me. They have a reason, eh, we don't want to necessarily pay you every day. But we'll pay you in two weeks. So that's the problem. It's this, it's this contradiction between people who wanna receive things immediately or fast and people wanting to send it immediately and fast. And that takes a while to build up the use cases and demand for that product.

WESSEL: I see. Okay. Well, governor, thank you for your time. Thanks for coming.

WALLER: Thank you all. I appreciate it.