

TEN

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FEDERAL RESERVE BANK OF KANSAS CITY

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More than I could have expected

On Oct. 1, 1991, my first day as president of the Federal Reserve Bank of Kansas City was spent in Washington, D.C., at a meeting of the Federal Open Market Committee (FOMC). In my mind, participating in the FOMC's eight yearly meetings seemed to be the most typical experience in the life of a Federal Reserve Bank president. Twenty years later, I know that a "typical" day as the president of the Kansas City Fed is more likely to involve any number of events, such as accompanying local business people and community leaders to a breakfast meeting in rural Nebraska; traveling 150 feet underground into a Wyoming trona mine; or visiting the Citizen Potawatomi Nation Cultural Heritage Center in Oklahoma. I had a front-row seat to view the regional economy.

It has been a distinct privilege to observe and explore the economy of the Tenth Federal Reserve District—western Missouri, Nebraska, Kansas, Oklahoma, Wyoming, Colorado and northern New Mexico—for the last two decades, and to relate it to our larger national economy. Although I came into this position after nearly 20 years at the Kansas City Fed, I did not fully appreciate the rewarding experiences that were ahead. I am grateful for the access that so many of you provided to your factories and businesses, your customers and employees, and your data and forecasts. Whether at public meetings, private conversations or suggestions by telephone, letter, or e-mail, your willingness to share information has been critically important to my role in national policy decisions and discussions.

During my career, I have been increasingly convinced of the importance of the Fed's decentralized structure and the central bank's obligation to include a wide range of views in its policy deliberations. Those with an interest in the Federal Reserve's history know that its congressional founders recognized the most effective way to serve a nation as broad and diverse as ours was to create a central bank that provided the means for reflecting that diversity while limiting

outside influences—political or financial—on central bank policy.

In the 98 years since the Fed's creation, there has been a gradual move toward highly concentrated financial power in New York and the consolidation of the central bank's authority in Washington. Recently, this has accelerated. I have voiced my concerns about the dangers of such moves at length, especially during the recent financial crisis.

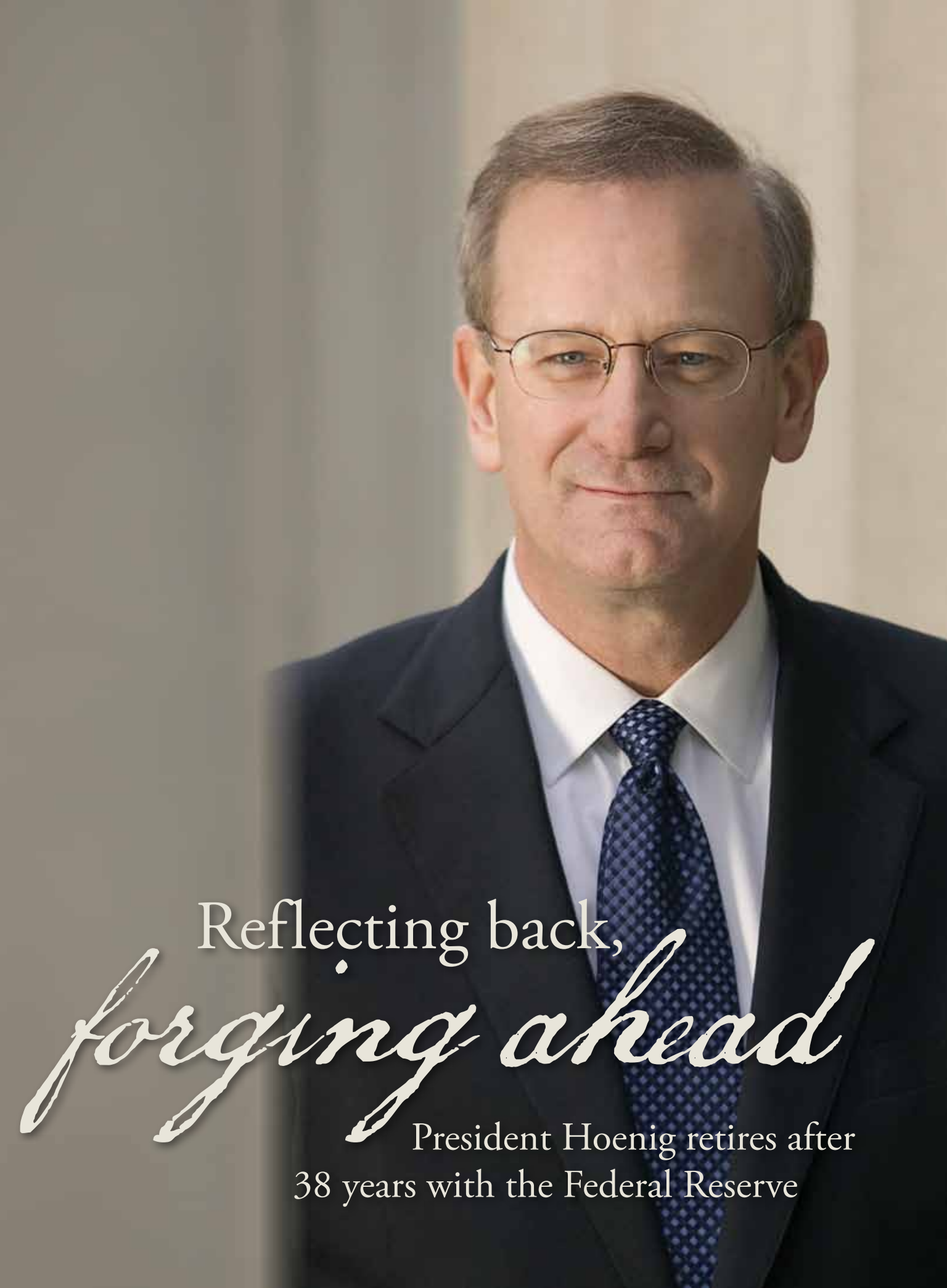
Given the damage this recession has done, especially in terms of the large number of Americans who have lost homes and jobs, it is unimaginable that so little has been done to address the risks the largest financial firms continue to pose. Despite claims to the contrary, I believe we have done little to prevent a repeat of these events in the near future and that some of our policy actions may in fact be laying the groundwork for an even worse outcome in the years ahead.

Throughout my tenure, it has been my pleasure to serve with the many exceptional individuals who are and have been directors, advisors and employees of the Federal Reserve Bank of Kansas City. The Kansas City Fed has a long history of working closely with regional businesses and communities. It is my belief that these relationships will only strengthen and grow in the years to come—and necessarily so in order to ensure local access to credit, cash and services, and local input to national policy.



A handwritten signature in black ink that reads "Thomas M. Hoenic". The signature is fluid and cursive, with a long horizontal stroke at the end.

THOMAS M. HOENIG, PRESIDENT
FEDERAL RESERVE BANK OF KANSAS CITY



Reflecting back,
forging ahead

President Hoenig retires after
38 years with the Federal Reserve



When Tom Hoenig walked into the Federal Reserve Bank of Kansas City's headquarters at 925 Grand Blvd. on Aug. 1, 1973, he was starting on a path that no one else had taken. Although the Bank hires many employees directly out of college, Hoenig is the first one to rise through the ranks to the Bank presidency, an office he would hold longer than any of his predecessors.

Hoenig, the second of seven siblings, was born Sept. 6, 1946, in Fort Madison, Iowa. Hoenig's father was a plumbing contractor in the river town along the Illinois border just north of the Missouri state line who took on big jobs when the economy was thriving and did home plumbing repairs when times were slow.

"It was kind of a Tom Sawyer/Huck Finn upbringing on the Mississippi River," Hoenig recalled in a 2010 interview for the Bank's archives. "We did a lot of camping on the islands in the middle of the river and had a lot of fun."

He left Iowa in the mid-1960s to attend what was then called St. Benedict's College in Atchison, Kan., earning a bachelor's in

economics and mathematics from the school, which was later renamed Benedictine College. Plans for graduate school were delayed by the draft.

"I knew the day I was drafted where I was going, so I spent a year in Vietnam," Hoenig said. "I got put into the artillery, which I was thankful for."

Having a background in math, Hoenig was assigned to fire direction control for a gun unit that supported infantry movements. Hoenig's team calculated the setup and instructions to the gun crews directing fire to the target. It was a high-pressure environment where an error in calculation could have tragic results. Because of his experience, he was eventually involved in reviewing the work of his peers during official investigations of errors and misfires. During this period, which Hoenig later referred to as "a maturing year," he continued to apply to graduate schools and took an accounting course by mail.

Once back in the states, he married Cynthia Stegeman, whom he'd started dating as an undergrad. The couple moved to Ames, Iowa, where he pursued a master's degree, and



The Federal Reserve's Federal Open Market Committee meets eight times a year in Washington, D.C., to consider adjustments to the nation's monetary policy. President Hoenig (on the far left side of the table) has participated in the meetings for 20 years.

later a doctorate, from Iowa State University. Although many seeking post-graduate degrees hope to one day teach, Hoenig's focus was on working at the Federal Reserve.

His interest, he said, had been sparked after hearing a Federal Reserve Bank of Kansas City official speak to students at St. Benedict's. In graduate school he did everything he could to position himself in a way that would make it a reality, passing his macroeconomic qualifying examination with distinction. While visiting Kansas City in 1971 he saw a newspaper article about how the Kansas City Fed had created the Division of Bank Supervision and Structure, that, among other things, would conduct financial and competitive analysis on bank mergers. The division would be led by Wilbur Billington, an economist on the Bank's staff.

"So, I cut the article out and, in 1973, when I began looking for work, I pulled it out," Hoenig said. "I wrote Wil a letter with my résumé and my background and sent it to

him. They happened to be looking for people at that time who had an interest in banking as well as monetary policy, so he called me and asked if I would be interested in interviewing for the job."

In fact, he ended up being offered jobs at Federal Reserve Banks in both Kansas City and Chicago. He took the position in Kansas City, in part because of his familiarity with the area, but also because it was a unique opportunity that perfectly matched his interests.

In a September 2010 profile for *Bloomberg BusinessWeek*, journalist Paul Barrett wrote that "for a bookish young economist, writing reports on competitive conditions for agricultural finance was as good as it gets."

The 26-year-old Hoenig was responsible for reviewing bank mergers and acquisitions early in his career, a job that required a substantial amount of travel around the Tenth District. The work gave Hoenig an opportunity to see firsthand how monetary policy had an

impact on the economy. When agricultural and energy-related real estate values soared in the 1970s and '80s, Hoenig, who was promoted to assistant vice president in 1979 and vice president in 1981, was working in supervision during one of the most tumultuous periods of the region's financial history: the banking crisis of the 1980s. When values for these assets began to tumble in the collapse of a speculative bubble, Hoenig was heavily involved with cleaning up the resulting aftermath—a process that saw 350 Tenth Federal Reserve District banks either close or receive assistance.

“What I took from that was that it followed a period of very easy credit,” Hoenig told Barrett. “It followed a period when people felt prices could only go up. It also followed a period where the Federal Reserve, with the best of intentions, kept interest rates too low for too long.”

The presidency

Hoenig was promoted to senior vice president of Bank Supervision and Structure in 1986, and on Aug. 13, 1991, the Bank announced Hoenig had been selected from a field of hundreds of applicants to succeed the retiring Roger Guffey as president. Less than a month past his 45th birthday, Hoenig was the youngest president in the Bank's history. His first day on the job, Oct. 1, 1991, he attended a meeting of the Federal Reserve's monetary-policy-setting Federal Open Market Committee.

Billington, who was Hoenig's mentor, later told a reporter that he was certain Hoenig had his eye on the Bank presidency early in his career. Hoenig, he said, didn't look simply at the job at hand, but focused beyond the immediate task.

“That's what propelled Tom along,” Billington said in the Oct. 15, 1991, edition of *The Kansas City Star*. “He didn't see things in isolation; he saw them in relation to the whole. That is one of his great strengths.”

Under Hoenig's leadership, the Bank engaged in one of the most significant projects in its nearly century-long history: the

construction of a new headquarters building at 1 Memorial Drive. The 600,000-square-foot building was built on a prominent Kansas City hillside that, in recent years, had become something of a city eyesore as the site of the vacant St. Mary's Hospital. The new headquarters replaced the Bank building at 925 Grand Blvd., which was built in 1921 and had become the oldest Federal Reserve building still in service.

Hoenig referenced the old building during the 2005 groundbreaking on a sweltering June afternoon.

“While our current facility is beautiful, it is unable to meet today's needs. So, here we are at this spectacular location, ready to begin the construction of a new building, which, when completed, will provide us a world-class facility—one that will enable us to remain a vibrant part of our 12-Bank system for at least the next 80 years,” Hoenig said. “It is my expectation that, upon its completion, we will be prepared to serve our nation, this great city of Kansas City, and the other great cities and towns in the heart of America that define the Tenth Federal Reserve District.”

The building, which opened in 2008, was



The placement of a time capsule in a cornerstone during the construction of the Bank's headquarters building at 1 Memorial Drive marked an important milestone in the Bank's history. Joining President Hoenig were, from left, Robert Funk, then-chairman of the Bank's Board of Directors; Lu Córdova, then-deputy chairman; and Rich Rasdall Jr., who was first vice president.

part of an evolution at the Federal Reserve Bank of Kansas City during Hoenig's tenure that perhaps is equaled only by that of Jo Zach Miller Jr., the Bank's founder and leader during the construction of the previous headquarters and the opening of Branch offices in Denver, Oklahoma City and Omaha.

Those Branch offices underwent a significant change during Hoenig's leadership. Each was remade to raise its participation in the Federal Reserve's monetary policy mission with regional economists moved to all three locations. In addition to serving as Branch executives, the economists are relied upon to closely monitor the economy in their part of the District through contact with local business leaders as well as conduct economic research.

Too big to fail, expectations of inflation

Although Hoenig's leadership on the new building project and at the Branches had echoes of Miller's presidency, the final years of

his career at the Federal Reserve Bank of Kansas City had a resonance with his early years at the Bank. The connection was not lost on Hoenig, an avid reader and student of history.

When he was named the Bank's president, much was said about what had already been a nearly 20-year career in bank supervision.

"As a regulator, Hoenig was a frontline witness to the economic turmoil that ravaged the region's agriculture and energy sectors in the 1980s," *The American Banker* wrote in its Aug. 15, 1991, edition. "Ushering banks through hard times was a painful but valuable experience."

Little did he know how valuable that experience would be.

In the aftermath of the 2007 recession, Hoenig was thrust upon a national stage as he spoke out frequently about the financial crisis and its causes, as well as the response to the crisis in terms of both regulatory changes and monetary policy. He cast the lone dissenting vote against the FOMC's easy money policies at each of the eight FOMC meetings in 2010 and

One of the most publicly visible projects completed under President Hoenig's leadership was the construction of a new headquarters in Kansas City. The facility replaced the Bank's long-time home at 925 Grand Blvd., which was, at the time, the oldest building in the Federal Reserve System.



was troubled by the FOMC's stated promise of keeping the federal fund rates at a historic low for "an extended period." The exceptionally low rates were creating a number of problems including a misallocation of resources—or a bubble—that, in turn, would lead to another similar crisis. He also spoke out frequently about the large and systemically critical financial firms known as "too big to fail," whose carelessness and mismanagement, he said, were a major cause of the crisis that grew even larger and more influential in its aftermath. Hoenig had warned about the dangers posed by these firms in a public speech more than a decade before the crisis.

"It's not just the Fed's loose-money policy that bothers Hoenig," David Von Drehele wrote in *Time* magazine's Feb. 14, 2011, edition. "He feels that little has been learned from the crisis and that government policy continues to smile on Wall Street but not on Main Street. Instead of breaking up the financial giants whose gambles crashed the economy, the government has let the biggest banks grow even bigger. Now they're gorging on free money. Where is the penalty for failure?"

Articles often mentioned that a framed 500,000 German mark produced when Germany faced hyperinflation hangs on his office wall. It was a gift from a neighbor that was also a dire warning about inflation: Although the note could have paid for a home at one time, a few years later it would have bought only a loaf of bread.

Although the note received much attention, Hoenig often explained that inflation can build momentum slowly over a long period of time. As an example, he noted that the soaring inflation of the late 1970s had roots going back a decade or more that later led up to the crisis in the 1980s.

Barrett, in the *BusinessWeek* profile, referred to Hoenig's views as a brand of "prairie populism."

Those who know him well, however, think of it another way.



Meeting with community leaders across the seven states of the Tenth Federal Reserve District requires a lot of time on the road. With an expansive and largely rural District, trips often meant long hours behind the wheel for President Hoenig.

"Tom has seen the good, the bad and the ugly, so people listen to him," Terry Moore, a Kansas City Fed director and president of the Omaha Federation of Labor, AFL-CIO, told *BusinessWeek*. "We feel like Tom represents the heartland view of the economy you don't necessarily get from New York or Washington. He's ... from Iowa, and we like that."

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BY TIM TODD, TEN CONTRIBUTING WRITER



Back to the business of banking

By Thomas M. Hoenig

Much remains to be done around reform if we are to ensure a more stable financial system, including focusing on housing, the Dodd-Frank Act, government-sponsored enterprises (GSEs), the safety net and other reform efforts that necessarily follow the recent financial crisis that has so devastated our national economy.

Understandably, major financial interests are lobbying to change and mitigate the impact of Dodd-Frank or influence the reform efforts that will affect the GSEs. One reform effort, for example, that is especially difficult for some interests to accept is the Volcker Rule. This rule will restrict banking organizations from engaging in proprietary trading activities and involvement with hedge and private equity funds. It will affect the largest institutions most directly, confining their risk profile and limiting the advantages of leverage that

currently drive behavior among these firms. How it is implemented will influence not only the behavior of these firms in the future but the discussion of other reform efforts yet to be undertaken.

I strongly support the Volcker Rule and suggest it should be implemented with resolve and should be strengthened in its reach and impact. Supporting my position is a more extensive white paper prepared with colleagues at the Federal Reserve Bank of Kansas City. This paper is posted on our Bank's website, www.KansasCityFed.org.

A brief history

A fundamental characteristic of the United States is that its citizens have an enormous suspicion and distrust of concentrated power—political or financial. For nearly 200 years, state and federal laws placed limits on bank

activities and resource concentration, resulting in a relatively open U.S. banking system that has served the country well. In fact, some of the largest institutions in this country started small: The Bank of New York, for example, was founded, in part, by Alexander Hamilton, and the Mellon Bank was founded by a farm boy who built his own financial empire. Thousands of banks, from small community banks to large global players, have operated in this country for most of our 200 years.

Banking in the United States thrived under the principles of competition and accountability—as opposed to having a few mega-institutions with the power to allocate a majority of financial resources and decide who wins and who loses. Rather, success followed a structure in which thousands of banks operated; competed; and, in the end, helped build the greatest middle class the world has known.

In 1913, when the Federal Reserve was brought into existence, 21,000 commercial banks operated across the country. At that time, the five largest banks controlled assets that we estimate were the equivalent of about 2.6 percent of our gross domestic product (GDP). As late as 1980, the United States had 14,000 commercial banks, and the five largest controlled, in assets, the equivalent of about 14 percent of GDP. Our nation had a lightly concentrated and highly competitive commercial banking and financial system. We saw the ascendancy of the United States as the greatest economic system in the world. And we saw our country change from an agrarian-based economy to a successful agriculture and industrial complex.

Today the United States has far fewer banks and a highly concentrated financial industry. We have fewer than 7,000 banks operating across the country. The five largest institutions control assets that are equivalent to almost 60 percent of GDP, and the largest 20 institutions control assets that are the equivalent of 86 percent of GDP. The remaining nearly 7,000

banks control assets the equivalent of only 14 percent of GDP. More noteworthy perhaps is the fact that it was several of the 20 largest institutions that nearly brought down the U.S. economy during this most recent global crisis.

We did not get to such a circumstance by accident or a Darwinian “survival of the fittest” process. We got there through policies that reflected good intentions along the way, but ultimately resulted in bad outcomes. Following earlier crises, such as the 1907 Panic and the Great Depression, we understandably wanted a more resilient system that protected small depositors. So, we first created the Federal Reserve and then the FDIC to provide a safety net of central bank liquidity for solvent banks and limited deposit insurance.

During the past 30 years, however, we have expanded the use of the safety net far beyond its original intent. During the crisis of the 1980s and early '90s, the government confirmed that some institutions were too systemically important to fail—the largest institutions could put money anywhere, and its creditors would not be held accountable for the risk taken. More striking perhaps in the late 1990s, despite recent experience, Congress repealed the Glass-Steagall Act, which separated activities protected through the safety net from a host of other more-highly risk-oriented and opaque activities.

As risks intensified and new crises emerged, this safety net was continually expanded to where the Federal Reserve, the FDIC and the Treasury were empowered to allocate enormous resources to ensure systemically important institutions didn't bring down the economy. This process inevitably led to the picking of winners and losers—not through competition and performance, but through bureaucracy. The result is increased concentration and, as just proven, less financial stability.

Also, as conditions allowed and

incentives encouraged, complexity within the financial industry expanded exponentially and so did industry risks. First, the expansion of the safety net enabled and encouraged banks to increase their return on equity by lowering capital levels and increasing leverage. Second, with the elimination of Glass-Steagall, the largest institutions with the greatest ability to leverage their balance sheets increased their risk profile by getting into trading, market making and hedge fund activities, adding ever greater complexity to their balance sheets. Third, perception was reality, as certain complex institutions were bailed out and therefore were in fact the safest places for money to go despite the risk. The market's ability to discipline was mitigated, and these institutions became so complex that supervision could not control their risk.

The conclusion of this experience is that the United States must reform its banking and financial structure if we hope to have a competitive; accountable; and, in the long run, less volatile system. There are good reasons to expand the Volcker Rule and to narrow the

scope of activities for institutions operating under the public safety net. The consequence of expanding the safety net to an ever-increasing range of activities is to invite a repeat of our most recent crisis. Yes, with separation of activities, risks will remain in the financial system, but unlike the past decade, this risk will be priced more correctly and failure can be resolved more equitably.

Proposal to reduce costs and risks to the safety net and financial system

Let me turn briefly to the reforms that I judge necessary if we hope to more successfully manage the risks and costs to the safety net and financial system. First, banking organizations that have access to the safety net should be restricted to the core activities of making loans and taking deposits and to other activities that do not significantly impede the market, bank management and bank supervisors in assessing, monitoring and controlling bank risk-taking. However, these actions alone would provide



Related research

Leading up to the financial crisis, the financial system had become dominated by a handful of large, complex financial organizations and it is even more so since the crisis. These companies combine traditional banking activities with a variety of nonbank activities. Banks benefit from additional activities, for example, if they increase the diversification of their assets and revenue streams. However, additional activities can also increase banks' riskiness and create complexity that makes it more difficult for the market, bank management and regulators to assess, monitor and/or contain risk-taking that endangers the public safety net and financial stability. Thus, the social costs of additional activities and the associated complexity can greatly exceed the private benefits to an individual bank.

Kansas City Fed President Tom Hoenig and Vice President and Economist Chuck Morris recently authored a proposal to reduce the costs and risks to the public safety net and financial system, and reintroduce accountability by restricting bank activities.

"Restructuring the Banking System to Improve Safety and Soundness" by Thomas M. Hoenig and Charles S. Morris is at KansasCityFed.org/research.

limited benefits if the newly restricted activities migrate to shadow banks without that sector also being reformed. Thus, we also will need to affect behavior within the shadow banking system through reforms of money market funds and the repo market.

Restricting activities of banking organizations

The financial activities of commercial, investment and shadow banks can be categorized into the following six groups:

- Commercial banking: deposit-taking and lending to individuals and businesses.
- Investment banking: underwriting securities (stocks and bonds) and advisory services.
- Asset and wealth management services: managing assets for individuals and institutions.
- Intermediation as dealers and market makers: securities, repo and over-the-counter (OTC) derivatives.
- Brokerage services: retail, professional investors and hedge funds (prime brokerage).
- Proprietary trading: trading for own account, internal hedge funds, private equity funds, and holding unhedged securities and derivatives.

This categorization of financial activities is from Matthew Richardson, Roy Smith and Ingo Walter.

Based on the criterion that permissible activities should not significantly impede the market, bank management and the supervisory authorities in assessing, monitoring and controlling bank risk-taking, banking organizations should be allowed to conduct only the following activities: commercial banking, underwriting securities and advisory services, and asset and wealth management services. Underwriting, advisory, and asset and wealth management services are mostly fee-based services that do not put much of a firm's capital at risk. In addition, asset and wealth management services are similar to the



KANSAS CITY FED PRESIDENT TOM HOENIG was honored by the Independent Community Bankers of America President Cam Fine at a May 3 ceremony in Washington, D.C., with the Main Street Hero Award, which recognizes public officials who promote the vitality of local communities. Hoenig has consistently supported a fair and competitive financial system.

trust services that have always been allowable for banks.

In contrast, the other three categories of activities—dealing and market making, brokerage, and proprietary trading—extend the safety net and yet do not have much in common with core banking services. Within the protection of the safety net, they create risks that are difficult to assess, monitor or control. Thus, banking organizations would not be allowed to do trading, either proprietary or for customers, or make markets because such activity requires the ability to do trading. In addition, allowing customer but not proprietary trading would make it easy to game the system by “concealing” proprietary trading as part of the inventory necessary to conduct customer trading. Also, prime brokerage services not only require the ability to conduct trading activities, but also essentially allow companies to finance their activities with highly unstable uninsured “deposits.” This combination of factors, as we have recently witnessed, leads to unstable markets and government bailouts.

The proposed activity restrictions will

enable and require bank management to focus their activities on the traditional banking business and manage their exposure to risks inherent in these activities. Banking is based on a long-term customer relationship where the interests of the bank and customer are more aligned. Both the bank and loan customers benefit if borrowers do well and are able to pay off their loans. In contrast, as shown only too clearly with this recent crisis, trading is an adversarial zero-sum game—the trader's gains are the losses of the counterparty, who is oftentimes the customer. Also, for those firms with access to the safety net and large amounts of credit, the advantage in the game goes to them. Thus, restricting these activities removes a conflict of interest between a bank and its customers, which encourages a more stable financial environment.

In addition, the inherent riskiness of securities trading, dealing and market-

asset-backed securities made it very difficult to determine their credit quality. As a result, “complicated” multilayer structured securities should be treated as other non-investment-grade assets are, and commercial banks should be limited or prohibited from holding them.

Critics of restricting activities have raised concerns that it would cause problems for U.S. banks because they would face a competitive disadvantage relative to universal banks that are allowed to conduct the full range of activities. They say it would drive U.S. banks and jobs to other countries. If this were accurate, it would be an unfortunate outcome, certainly. However, this conclusion should be considered carefully before it is accepted. First, we have 200 years of banking success in this country that tends to refute that assertion. Second, it seems improbable that any other country should be willing or able to expand its safety net to new large and complex banking organizations.

“ Reasonable risk is, in fact, part of the financial system and essential to our economic success. ”

making attracts, and in fact requires, people who are predisposed to taking short-term risks rather than lenders with a long-term outlook. The combination of securities and commercial banking activities in a single organization provides opportunities for the senior management and boards of directors to be increasingly influenced by individuals with a short-term perspective. As a result, the increased propensity of these corporate leaders to take high risks for short-term gain leads to more of a short-term-returns culture throughout the organization.

Historically, bank investments were restricted to loans and investments in investment-grade securities. As demonstrated in the financial crisis, the complexity of many

Third, and finally, the U.S. authorities should consider carefully whether it is wise to insure and therefore protect creditors of foreign organizations that operate in this country outside of the U.S.'s prudential standards.

Reforming the shadow banking system

Critics of restricting the activities of banking organizations also argue that it could worsen the risk of financial instability by pushing even more activities to the unregulated shadow banking system. I agree that focusing solely on the regulated banking industry would not solve the problem and might in fact expand the shadow banking sector that was an integral

part of the financial crisis.

However, much of the instability in the shadow banking system stemmed from its use of short-term funding for longer-term investment. This source of systemic risk can be significantly reduced by making two changes to the money market.

The first change addresses potential disruptions coming from money market funding of shadow banks—money market mutual funds and other investments that are allowed to maintain a fixed net asset value of \$1 should be required to have floating net asset values. Shadow banks' reliance on this source of short-term funding and the associated threat of disruptive runs would be greatly reduced by eliminating the fixed \$1 net asset value and requiring share values to float with their market values.

The second recommendation addresses potential disruptions stemming from the short-term repurchase agreement, or repo, financing of shadow banks. Under bankruptcy law, repo lenders receive special treatment as compared to other secured lenders because they are allowed to take possession of the underlying collateral if the borrower defaults. In other words, repo lenders are not subject to the automatic stay that all other creditors are subject to when default occurs. The bankruptcy law also specifies the eligible assets for the automatic stay exemption.

One of the changes in the 2005 bankruptcy reform law was to make mortgage-related assets used in repo transactions exempt from the automatic stay. Prior to 2005, only very safe securities were exempt from this stay. The change meant that all of the complicated and often risky mortgage securities could be used as repo collateral just when the securities were growing rapidly and just prior to the bursting of the housing price bubble. One of the sources of instability during the crisis was repo runs, particularly on repo borrowers using subprime mortgage-related assets as collateral. Essentially, these borrowers funded long-term

assets of relatively low quality with very short-term liabilities.

Therefore, to improve the stability of the shadow banking market, the bankruptcy law for repo collateral should be rolled back to the pre-2005 rules and eliminate the automatic stay exemption for mortgage-related repo collateral. This would discourage such activity and tend to reduce the potential instability that is associated with repo runs. Term wholesale funding would continue to be provided by institutional investors, such as mutual funds, pension funds and life insurance companies.

Overall, these changes to the rules for money market funds and repo instruments would increase the stability of the shadow banking system because term lending would be less dependent on “demandable” funding and more reliant on term funding, and the pricing of risk would reflect the actual risk incurred.

Conclusion

What I'm proposing will not take all risks out of the financial system. Reasonable risk is, in fact, part of the financial system and essential to our economic success. However, the proposal will improve the stability of the financial system by clarifying where risks reside; improving the pricing of risk; and, thus, enhancing the allocation of resources within our economic system. It also will promote a more competitive financial system, as it levels the playing field for all financial institutions. And finally, it will raise the bar of accountability for actions taken and, to an important degree, reduce the likelihood of future bailouts funded by the American taxpayers.

Kansas City Fed President Tom Hoenig gave this speech at the 29th Annual Monetary and Trade Conference at the Global Interdependence Center and Drexel University LeBow College of Business in Philadelphia on May 24.

A DRIVING FORCE

President Tom Hoenig led the Kansas City Reserve Bank in advancing technology

Technology is at the forefront of the Federal Reserve Bank of Kansas City.

During his 20 years at the helm, President Tom Hoenig oversaw technological advancements at the Kansas City Fed as it became a technology leader in the Federal Reserve System.

Hoenig was instrumental in advancing technology early on. Prior to becoming president, he raised eyebrows when he sent large personal computers and printers with bank examiners to financial institution examinations. It was an important introduction to technology and a transformation of the examination process—productivity and efficiency increased as a result. Now, technology supports examiners' analysis and the Kansas City Fed shares with other Reserve Banks an examination platform called the CBO INSite Banking System, which gives automated tools for calculating data and allows examiners to focus exam results.

As president, Hoenig was the first of the 12 regional Reserve Bank leaders to direct broad initiatives, serving as the head of the System's Information Technology Oversight Committee (ITOC) at its inception in 1998. ITOC sets the strategic direction and policy for Reserve Banks' activities necessary to

support their business lines.

Under Hoenig's leadership, the Kansas City Fed adapted its business from operational and clerical procedures to technology-driven practices at its own organization as well as at the System level. As a result of this technological shift over the past two decades, the Reserve Bank's workforce changed dramatically. Professional staff at the Kansas City Fed increased to 73 percent of its workforce in 2011 from 46 percent in 1991.

Today, the Kansas City Fed's Information Technology (IT) supports business areas at the Reserve Bank and the System through innovative information technology solutions and leadership for the National Service Desk, Internal Network Services, the Server Management Transition Project, Application Delivery Services and Treasury Services.

Additionally, it is responsible for providing a substantial portion of the technical support for the Federal Reserve System's paper and electronic check processing systems. The Reserve Bank also leads the Payment Director Project for the System's Retail Payments Office, which will provide a more efficient electronic check processing system.



1991

Operational/Support Staff



Professional Staff



2011

Operational/Support Staff



Professional Staff



Presidents of the Tenth District

THE POSITION OF *president* OF THE FEDERAL RESERVE BANK OF KANSAS CITY HAS PROVEN TO BE ONE OF THE MOST *stable leadership* POSITIONS IN THE ENTIRE FEDERAL RESERVE SYSTEM.

Thomas M. Hoenig was appointed the Bank's eighth president in 1991. Of the 12 regional Reserve Banks, only the Richmond Federal Reserve Bank, with seven presidents, has had fewer leaders in the central bank's nearly century-long history. But unlike Richmond, which, astonishingly, had only two presidents during its first 46 years, the Kansas City Bank's first leaders were the ones with the briefest tenures. Each of the last four Kansas City Bank presidents has held the post for more than 14 years.

That is not to downplay the importance of the early presidents.

The leadership and vision during the Bank's early years very literally established the Bank's foundation.

Similarly, each president's successors has built upon that foundation. They've led the Bank through the challenges of their times, and, despite their varied backgrounds, brought to the job a strong commitment to the Bank and the Tenth Federal Reserve District.

The most telling sign of their success is perhaps that, nearly a century after the Bank's founding, so few have held the job.



CHARLES MANVILLE SAWYER, 1914-1916

Charles Sawyer occupies a unique spot in the history of the Federal Reserve Bank of Kansas City. Although he was the first to hold the position that would later become president—at the time of the Bank's founding the title was "governor"—his tenure in that office is the briefest in the Bank's history because of confusion about the job's responsibilities.

Sawyer was one of eight children born to Lewis and Salanda Sawyer on a farm near Streator, Ill. At the urging of a brother-in-law, Sawyer moved to the northwestern Kansas town of Norton in 1887 and, at age 21, became cashier at the First National Bank of Norton—the first steps in a banking career.

After leaving his cashier job to work as a national bank examiner, Sawyer returned to the bank as its president. With broad connections to banks in northwest Kansas, Sawyer was named president of the Kansas Bankers Association in 1898. Kansas Gov. George H. Hodges appointed Sawyer as Kansas banking commissioner in 1913. In October 1914,

the Board of Directors of the Federal Reserve Bank of Kansas City selected him to serve as governor.

Today, little is known about Sawyer's tenure, other than it soon became apparent that Sawyer's skills were perhaps better suited for serving as chairman of the Bank's Board of Directors while the first chairman, Jo Zach Miller Jr., seemed to have the skills more suited for the governor's job. In January 1916, steps were taken to have the two men switch roles. Sawyer served as chairman until December 1917.

He eventually moved to Hollywood, Calif., where he died on Sept. 26, 1950, at age 84.

JO ZACH MILLER JR., 1916-1922

Although many individuals were responsible for the founding of the Federal Reserve Bank of Kansas City, including numerous community leaders from throughout the Tenth Federal Reserve District who loudly argued for the nation's central bank to locate a regional headquarters in Kansas City, none is more important to the Bank's establishment than Jo Zach Miller Jr.



Jo Zach Miller Jr. in the lobby of the Federal Reserve Bank of Kansas City building at 925 Grand Blvd. on opening day in 1921.



Jo Zach Miller Jr. sits for a portrait by French artist Charles Bennell. The portrait was unveiled in April 1922, shortly before Miller's retirement. It now hangs in the Federal Reserve Bank of Kansas City's headquarters at 1 Memorial Drive.

Born on April 16, 1863, on a farm southeast of Austin, Texas, he was left fatherless at age 11. Raised by his mother Amanda and the uncle for whom he was named, Joseph Zachery Miller, he would become a self-made man. After attending school at St. Louis University, Miller returned to Texas where he became prominent in banking and had a wide range of other business interests over the following three decades.

In 1910, he came to Kansas City where he began working as a vice president for Commerce Trust Company. Four years later, he was chosen by officials in Washington to serve as chairman of the Federal Reserve Bank of Kansas City, a post that involved all aspects of founding the Bank, including hiring staff and securing necessary office space. Before accepting the appointment, Miller had to divest all bank holdings and assume a comparatively modest salary of \$7,500.

“Only a worthy desire to be of patriotic service can justify such a sacrifice,” reads one newspaper account about his selection. “And the people of (Federal Reserve) District number 10 are fortunate for having such a man available for service.”

Less than two years later, when it became clear that Miller was ideal to oversee the Bank's day-to-day operations, he switched jobs with Charles Sawyer to serve as the Bank's governor.

As Bank governor (president), Miller was known for many quirks, including his refusal to own an automobile and his meticulous bookkeeping, but, most prominently, he was known as a hard worker who never took a day of vacation and who was dedicated to the Federal Reserve and the banks and communities of the Tenth Federal Reserve District.

A local newspaper gossip columnist once wrote that Miller was “the first to work in the morning and the last to leave at night. He has

more fun working on holidays than at any other time.”

He very literally established the Bank, supervising the construction of the Bank's headquarters at 925 Grand Blvd. and the creation of Branch offices in Denver, Oklahoma City and Omaha.

“When the Bank became properly housed in the new building and the various departments were working harmoniously and with adequate room and working facilities, Gov. Miller's greatest ambition was achieved, and he began looking forward to a vacation of which he had deprived himself during his connection with the Bank,” reads a Bank history authored around the time of Miller's departure.

He went on to be involved in numerous local business efforts before a lengthy illness led to a 13-month stay in St. Mary's Hospital, which stood on the 1 Memorial Drive property that is now home to the Federal Reserve Bank of Kansas City headquarters. He died at age 87 on Feb. 16, 1951.

A *Kansas City Times* editorial published a few days later on Feb. 19, 1951, called Miller “one of the salty characters of Kansas City.

“An intense individualist, a man of deceptively modest appearance, but of immense force, where ‘J.Z.’ sat was the head of the table.”

Miller, the editorial said, “was of the hardy pioneer type that laid the foundations for American progress. The West, in which his lot was cast profited greatly from the shrewd independence of men like him who for so many years kept the nation's economy on an even keel.”

WILLIS JOSHUA BAILEY, 1922-1933

When Willis J. Bailey became governor (president) of the Federal Reserve Bank of Kansas City, it was not the first time he had been referred to by that title.

Bailey, the founder of the northeast Kansas community of Baileyville, was elected the state's 16th governor in 1902, the culmination of a political career that had already seen him serve two terms in the Kansas legislature and a congressional term.

Born Oct. 12, 1854, in Mount Carmel, Ill., Bailey came to northeast Kansas to live on farmland owned by his father where, in addition to starting the town, he operated a large livestock operation. In addition to his political career, he founded the Baileyville State Bank in 1895. He returned to banking after leaving the Kansas governor's office, moving to Atchison, Kan., and becoming managing officer and vice president at Exchange National Bank. He later became the bank's president.

As a banker, he was elected president of the Kansas Bankers Association, which put him in a key position when Congress passed the

Federal Reserve Act in December 1913. When federal officials were working to determine locations for the nation's regional Federal Reserve Banks in 1914, Bailey was especially active. Under his leadership, the KBA and its members were a strong voice in favor of locating a Reserve Bank in Kansas City. Perhaps in recognition of his efforts, in 1914 he was selected to serve on the Bank's first board of directors. After

Jo Zach Miller's resignation, Bailey's fellow directors selected him for the job.

“Language is inadequate for me to express to you the sincere appreciation that I feel



Willis Bailey had a lengthy political career in Kansas before coming to the Federal Reserve Bank of Kansas City. He served terms in the state's legislature, as governor and in Congress.

for the great honor you have just done me in making me the governor of this Bank,” Bailey told the Board.

As Bank president, Bailey was known to refer to the Tenth Federal Reserve District as “the bread basket of the world,” and during at least one meeting in New York, where the discussion focused on securities investments, he was critical of those taking part, saying that they were creating wealth simply by changing bookkeeping.

“Out in the Tenth District we brought \$3 billion in new wealth from the soil last year,” he proclaimed.

In a 1932 article about Bailey, *The Kansas City Star* wrote that he had the ability to “humanize” the Federal Reserve.

“Gov. Bailey took a broad leadership and human understanding to the position,” the newspaper said. “He knew Tenth District bankers and the customers in back of them.”



George Hamilton's performance at the helm of the Federal Reserve Bank of Kansas City during the 1933 banking holiday was praised by the local media.

His final years in office were marked by poor health and at least one extended leave of absence. He was forced to retire in January 1932. He died five months later at age 77.

Because of his role in the Bank's founding, Bailey's funeral was among the most historically significant events in Bank history. Among the attendees were several individuals who had been a part of the effort to locate the Bank in Kansas City. Meanwhile, a lengthy list of honorary pallbearers at his funeral included Bailey's successor at the Bank, George Hamilton, as well as Gavin Leedy, who, years later, would succeed Hamilton in the office.

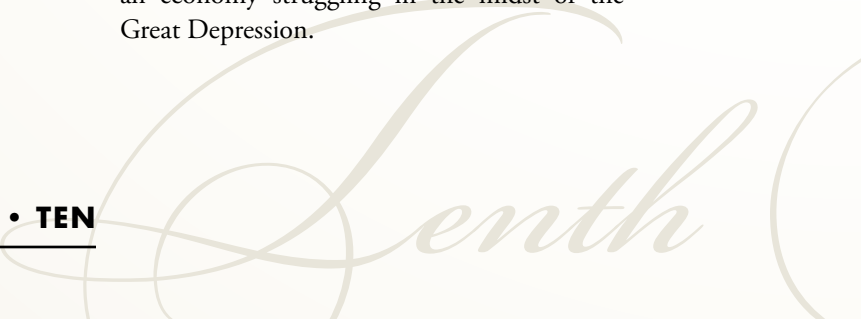
GEORGE HENRY HAMILTON, 1932-1941

Like Willis Bailey, George Henry Hamilton came to the Tenth District from Illinois.

Born April 4, 1875, on a farm near Wellington, Ill., he was an attorney who later became involved in banking and served three terms in the Illinois legislature. He came to Kansas in 1912 after purchasing the State Savings Bank in Wichita, Kan., where he served as president until its merger with Fourth National Bank, where he eventually rose to president.

He was prominent in both banking and in the city. As a banker, he was a featured speaker at the American Bankers Association's 1929 annual meeting where he called for a change in banking laws. He also served three years on the Wichita City Commission, a stint that included one year as the city's mayor. The Federal Reserve Bank of Kansas City's Board of Directors unanimously elected him Bailey's successor on Jan. 7, 1932.

“The Tenth District directors have used exacting care in canvassing for a man of strong character and comprehensive experience to take the governorship at one of the important periods in the Bank's usefulness,” *The Kansas City Star* wrote with an obvious reference to an economy struggling in the midst of the Great Depression.



A year after Hamilton had taken office, President Franklin D. Roosevelt suspended banking activity nationwide to give Congress time to provide a solution to the worsening banking crisis.

James H. Joyce, an employee at the Kansas City Fed's Denver Branch, later recalled the environment during the bank holiday.

"I think this was the only time in my life that I had doubts that the sun would rise the next day," Joyce later recalled. "Bankers were coming into the Fed with suitcases of collateral. I thought it was the end of the world, but it was not and the banks eventually opened up."

The Kansas City Star later wrote that Hamilton was "a calm, level-headed executive" during the bank holiday and was "intent on a program constructive for this area."

During his tenure, Congress passed both the Banking Act of 1933 and the Banking Act of 1935. Both pieces of legislation made numerous changes to the nation's financial infrastructure, including the establishment of the Federal Reserve's policy-setting Federal Open Market Committee. Other provisions of the legislation changed the structure of the Federal Reserve Banks in several ways, including changing Hamilton's job title from "governor" to "president" and instituting mandatory retirement provisions that remain in place today.

When Hamilton faced mandatory retirement a few years later, a group that included Tenth District bankers and members of the Bank's board of directors went to Washington, D.C., to argue that Hamilton be allowed to continue to serve, but the requests were rejected. He retired on Feb. 28, 1941.

"These have been interesting, happy years of work," Hamilton told *The Kansas City Star* for an article published on the day of his departure. "It has been sufficiently different from commercial banking to constitute a liberal education. Considering this, and a broadening acquaintance, I feel I got more out of the Bank than the Bank got out of me."

He returned to Wichita and served as vice



Harold Gavin Leedy, who went by his middle name, was raised in rural Missouri and obtained his degree from William Jewell College.

president of Fourth National Bank. He died at age 72 on Jan. 19, 1948, after a brief illness.

HAROLD GAVIN LEEDY, 1941-1961

After George Hamilton's retirement, the Federal Reserve Bank of Kansas City was without a president for six months. Although Federal Reserve Banks would later operate for extended periods with an interim president, the gap between Hamilton's departure and Gavin Leedy's appointment was the longest period any of the Banks went without a president.

Born Dec. 6, 1892, in the small southern



In addition to his career as an attorney, George Clay was a professional singer and worked closely with Howard Hughes at TWA before coming to the Federal Reserve Bank of Kansas City.

Missouri town of Benton, Leedy was a child when his family moved north to Cameron, Mo., in hopes of improving his mother's health.

After graduating from William Jewell College in Liberty, Mo., Leedy came to Kansas City in 1916 and attended law school while he worked for banking law attorney James Goodrich. His education, however, was interrupted by war. A member of the first graduating class at the Officers' Candidate School at Fort Riley, Kan., in 1917, Leedy served in France where he was injured during an artillery attack. When he returned to the United States in October 1918 he was among a group of military officers lauded as heroes and honored with a luncheon in New York.

After returning to Kansas City, he graduated from the Kansas City Law School and began to work for Goodrich while also teaching night classes at the school where, among his students, was future-President Harry Truman. When Goodrich dissolved the firm, Leedy started his own practice, which was active in banking law during the Great Depression.

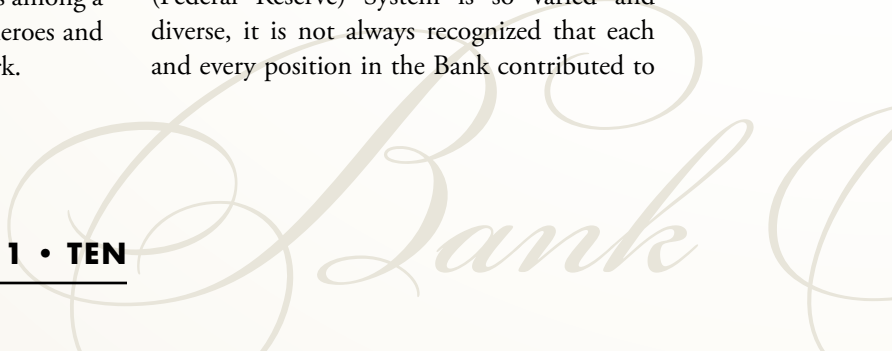
"Leedy was a lawyer-doctor, constantly being called to the bedside of sick banks," according to a biographical sketch written in 1952 for a book titled "Leaders in Our Town." "Throughout this part of Missouri, Kansas and Oklahoma he worked on reorganizations, mergers and liquidations. This was not only legal work, but a wide exploration into the fundamentals of banking. He learned the causes of health and illness as a young doctor learns from a clinic and post mortem operations."

He joined the Federal Reserve Bank of Kansas City as vice president, general counsel and secretary to the Bank's board of directors in February 1938. The Bank's board appointed Leedy first vice president at the time of Hamilton's retirement and six months later he was named president. Today, little is known about the reasons behind the six-month delay in making Leedy president, although media accounts at the time suggest the board of the Kansas City Reserve Bank and the Fed's Board of Governors in Washington, D.C., may have had some disagreement about the appointment.

Bank employees under Leedy recalled that the institution felt more like a family during his tenure, with Leedy acting as the father. It was a growing family, going from 600 employees at the start of his tenure to more than 1,200 at the time of his 1961 retirement.

In a retirement message to employees, Leedy wrote that his time at the Bank "could not have been more satisfying or enjoyable.

"As we all recognize, this is a unique organization we serve," Leedy wrote. "The scope of the Bank's activities as part of the (Federal Reserve) System is so varied and diverse, it is not always recognized that each and every position in the Bank contributed to



the System's great goals. To have been in the center of this complex work all these years has been an experience I would not trade for any other. It has been completely absorbing and exhilarating throughout. I cannot begin to count my blessings."

Leedy died at age 96 on July 28, 1989.

GEORGE H. CLAY, 1961-1976

George Clay was the first native of the greater Kansas City area to serve as president of the Federal Reserve Bank of Kansas City.

Born Feb. 14, 1911, in Kansas City, Kan., Clay attended Kansas City Junior College and Liberty's William Jewell College before enrolling at the University of Missouri – Columbia, where he earned a law degree.

He practiced corporate law for a decade until 1944 when he joined another Kansas City-based institution: Trans World Airlines. Clay started at TWA as the assistant director of state affairs and rose to become TWA's vice president of administrative services and

a member of its Board of Directors. Among other things, he was heavily involved with developing New York City's John F. Kennedy Airport and in consolidating TWA's overhaul base from Delaware to Kansas City—a key component in the later expansion of what was then known as Mid-Continent International Airport into Kansas City International.

Clay left the airline in 1958, coming to the Federal Reserve Bank of Kansas City as vice president and general counsel. The move was influenced by his love of Kansas City and the recognition that remaining at TWA would eventually require a move to New York, but also a firm belief that "everyone should spend some time paying his rent for his place in the world.

"I thought the Federal Reserve Bank was ... an excellent place to find opportunities for both public service and challenge."

During his 15 years as the Bank's president, Clay was known for his open-door philosophy, sense of humor and leading the staff in singing holiday carols.

He was also a staunch defender of the Fed-



The Oct. 9, 1968, meeting of the Federal Reserve's Federal Open Market Committee, George Clay is seated at the far end on the right side of the table. Then-Federal Reserve Chairman William McChesney Martin Jr. is on the left side of the table in the middle with his elbow resting on his chair. Martin is the longest-serving Federal Reserve chairman, holding the position for 18 years and nine months.

eral Reserve's decentralized regional structure.

"The (Federal Reserve) System's foundation rests firmly in regional orientation which has served the nation well," Clay said at the time of his retirement. "It's a sound blending of public and private interests focused toward an efficient financial system and the overall health of the nation's economy. Regionally, we have supervisory and operational responsibilities with the banks in our own area. We take regional views to national forums.

"This arrangement permits the System to have a better chance to accomplish objectives through solid policies developed in a free and open manner. This is true for monetary policy, bank regulations, our own operations—every aspect of our activity. These Fed traditions are really closely related to traditions of liberty and freedom of choice we all prize so highly. The Fed is an institution that was well conceived and generally has been well administered. I hope its strengths can be preserved while it changes in response to the needs of the nation."

When he retired in February 1976 he was the longest-tenured member of the Federal Reserve's policy-setting Federal Open Market Committee.

"The creation of money and credit is a

very complicated thing," Clay said in a 1976 interview with *The Kansas City Star*. "It's not a science with its rules carved in marble. It's an art. Though it is pretty easy to take the first step in the creation of money and credit, what happens in six months as a result of that step is impossible to predict."

In retirement, he remained involved in charitable efforts and the business community. He died at age 84 on Oct. 11, 1995.

J. ROGER GUFFEY, 1976-1991

J. Roger Guffey was happily pursuing a career as a partner in a law firm when the Federal Reserve Bank of Kansas City came calling in the late 1960s and put him on a path that would later lead to the Bank's presidency.

Guffey was born Sept. 11, 1929, in Kingston, Mo. He earned a degree in business administration from the University of Missouri – Columbia in 1952 and, after three years in the Army working with intelligence forces in Germany, he returned to MU to earn a law degree.

He was a partner in the Kansas City law firm Fallon, Guffey and Jenkins, a firm he had

Although Federal Reserve Bank presidents are perhaps best known as members of the Federal Open Market Committee, their jobs involve a wide range of activities and interaction with the public. Here, Roger Guffey talks with local students about banking and finance.



spent a decade building, when then-President George Clay invited him to the Kansas City Fed for lunch and convinced the attorney that a few years at the Federal Reserve would benefit his law practice by improving his understanding of banking issues.

“My concern was that I’d walk through those big doors and I heard them slam behind me one morning and realize that I only had one client and if I didn’t like that client, what was I going to do?” Guffey later said.

He started at the Bank as general counsel in 1968. He became senior vice president of the Administrative Services Division in 1973 and on March 1, 1976, became president.

A child of the Great Depression, Guffey was at the helm of the Federal Reserve Bank of Kansas City and a member of the Federal Reserve’s Federal Open Market Committee during a period sometimes referred to as the Great Inflation. In that position, he was a participant at the meeting that is seen as a key moment in Federal Reserve history—the turning point in the FOMC’s battle against inflation.

With double-digit inflation and public expectation that inflation would continue to escalate, the FOMC, under the leadership of Chairman Paul Volcker, needed to take dramatic action. At a rare Saturday meeting on Oct. 6, 1979, the FOMC decided to shift the conduct of its open market operations to a focus on controlling the money supply by reducing bank reserves instead of its traditional targeting of the federal funds rate. It was a move designed to kill inflation, and while it was successful, it was not painless. The resulting jump in interest rates, with the prime rate hitting a record-setting 21.5 percent in December 1980 and remaining above 17 percent for much of 1981, touched off a recession in the months that followed.

“I think back on that event as a tough decision,” Guffey said in 1991. “There were divergent views as to whether the draconian steps that we would eventually take were



Roger Guffey was working as a partner in a law firm when then-Federal Reserve Bank of Kansas City President George Clay convinced him to work for the Bank. Just eight years later, Guffey was president.

necessary and whether the price that thereafter was paid by the nation was worth the effort. I happened to think it was and I look back upon that with some warmth and the sense that it was a tough decision and it turned out to be the right one. I think it really demonstrates the positive impact the Federal Reserve can have on the nation.”

The decision, he said, also showed the importance of an independent central bank.

“There is no way that you could have approved what we did on Oct. 6, 1979 through our Congress...,” Guffey said. “It’s very difficult for elected officials to make those kind of hard decisions. That’s the reason I think our form of a central bank is very important and worth preserving. It’s worked and it will continue to work.”

During Guffey’s tenure he founded the Bank’s annual economic policy symposium, which has become a widely respected event for central bankers, economists and academics. He retired in September 1991.

He died at age 79 on April 15, 2009. The theater in the Bank’s headquarters at 1 Memorial Drive is named in his honor.



BY TIM TODD, TEN CONTRIBUTING WRITER

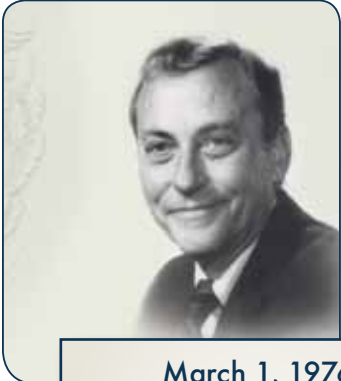
Gaining experience, building perspective

With a career that spanned nearly four decades at the Federal Reserve Bank of Kansas City, Tom Hoenig played a unique role in the sweeping changes that took place in our nation's economy, financial system and central bank.





July 28, 1975
Hoenig is promoted to manager of Bank Studies and Structure.



March 1, 1976
Roger Guffey becomes president of the Federal Reserve Bank of Kansas City, succeeding George Clay.

Aug. 1, 1973
Thomas M. Hoenig joins the Federal Reserve Bank of Kansas City as an economist in the Bank Supervision and Structure Division. The Board of Governors is chaired by Arthur Burns.



1973 ••••• 1974 ••••• 1975 ••••• 1976 ••••• 1977 •••••

July 1973

The Board of Governors voted by a 4-3 margin to deny a request by BankAmerica to acquire GAC Finance Inc. to create the world's largest non governmental bank with the 16th-largest finance company in the United States. By the end of August a new plan was submitted and the Board approved it. BankAmerica ended up putting the GAC Finance unit up for sale a decade later amid a slumping financial performance.

August 1973

A *Wall Street Journal* editorial says rising interest rates are a sign of the steepening costs of fighting inflation that had been fostered by a period of easy money.

November 1973

U.S. economy enters a **recession**.

Oct. 8, 1974

President Gerald Ford says that **inflation** is "public enemy number one" in his "Whip Inflation Now" speech. Supporters begin wearing red buttons featuring the acronym "WIN" while critics wore the buttons upside down and said they stood for, among other things, "No Immediate Miracles."

March 1975

U.S. economy emerges from **recession**.

Oct. 12, 1977

President Jimmy Carter signs the **Community Reinvestment Act**, designed to encourage lending to low- and moderate-income communities. Community Affairs offices are later established at each Federal Reserve Bank.



“At the start of the 1980s, we were told that oil prices could only go higher, farmland was a solid investment because ‘they aren’t making any more of it,’ and housing and stock markets would continue to climb. Of course, if you were involved in business or banking (at that time) ... you will recall that several of the financial decisions made on those speculative forecasts created their own sets of problems, some reaching far beyond local banks.” —Thomas Hoenig, “This Time It’s Different (Or Is It?),” Oct. 30, 2006, Tucson, Ariz.

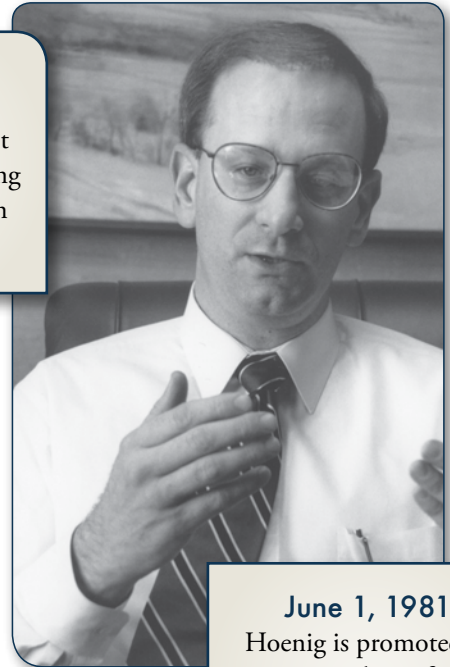
May 18, 1978

The Federal Reserve Bank of Kansas City hosts the symposium “World Agricultural Trade: The Potential for Growth” in Kansas City. The event is the first in the annual **economic symposium** series.



Feb. 1, 1979

Hoenig is appointed assistant vice president in charge of the Holding Company Supervision Department.



June 1, 1981

Hoenig is promoted to vice president of the Holding Company Supervision Department.

1978

March 8, 1978

G. William Miller becomes Federal Reserve chairman.

Aug. 6, 1979

Paul Volcker becomes Federal Reserve chairman.



1979

Oct. 6, 1979

The Federal Open Market Committee (**FOMC**), in a key move in the fight against inflation, announces a change in policy to begin targeting the money supply instead of the federal funds rate.

1980

Inflation hits 13.5 percent in the United States. It is the highest level since 1947.

1980



April 1980

Oil prices hit then-record \$39.50 per barrel (\$103.76 adjusted for inflation). By mid-1986, prices were back below \$10 a barrel.

1981

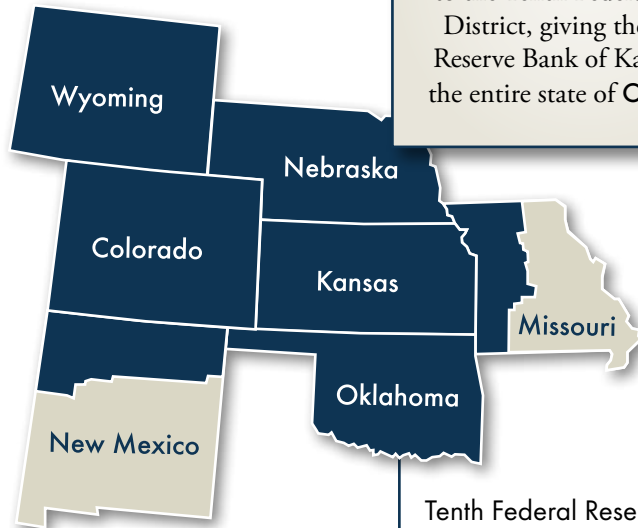


Aug. 9, 1982

The **economic policy symposium** convenes for the first time in its now-traditional home of Jackson Hole, Wyo., with the theme “Monetary Policy Issues in the 1980s.”

May 21, 1984

Eight counties in southeastern Oklahoma are moved from the Eleventh Federal Reserve District to the Tenth Federal Reserve District, giving the Federal Reserve Bank of Kansas City the entire state of **Oklahoma**.



Tenth Federal Reserve District

1982

1983

1984

1985

July 5, 1982

Oklahoma City’s **Penn Square Bank** fails. Although it was a small institution, it had sold energy loan participations to numerous larger banks that suffered the consequences.



November 1982

U.S. economy exits a **recession**.

May 1984

Continental Illinois National Bank and Trust Company, the nation’s seventh-largest bank by deposits, collapses and is put through a resolution process. The events are seen as originating the concept that a financial institution could be considered **too big to fail** without doing substantial harm to the nation’s financial system.





Penn Square:

Big problems from a small bank

When Oklahoma's Penn Square Bank failed in the summer of 1982, it was not only a precursor of things to come for numerous banks across the Midwest and the Plains, but it also showed how the failure of a single but well-connected institution, regardless of its size, could introduce turmoil to the nation's banking system.

And it was also an important event in the career of the man who would later become president of the Federal Reserve Bank of Kansas City.

Formed as a small one-office bank in 1960, Penn Square was purchased in 1975 by a holding company created by one of its former presidents. A year later, it formed a loan department for oil and gas lending.

"From the beginning, the bank failed to document loans properly," the Federal Deposit Insurance Corporation (FDIC) wrote in a later analysis of the bank's failure. "In addition, it based repayment on collateral value rather than on the ability of the borrower to repay, and collateral documentation deficiencies were common."

The problem was compounded by the bank's numerous relationships with other financial institutions. Although the Office of the Comptroller of the Currency (OCC) limited how much credit Penn Square could extend to an individual borrower, the bank would still make the loan and then sell off loan participations to some of the nation's largest banks nationwide, spanning from New York City to Seattle.

Why would the big institutions become involved with a small energy lender? That's where the money was.

The United States was in an oil crisis where prices soared and supplies dwindled. In oil-rich states, though, it was a boom. Penn Square's balance sheet swelled from \$62 million in assets in 1977 to \$520 million only five years

later when it was servicing \$2 billion in loans.

"Energy lending was the hottest ticket in banking then," Tom Hoenig recalled during a 2006 speech. "(I)n the race to stake out a position, none of these major banks (that bought loan participations) paid any real attention to Penn Square's loan underwriting and administration or did much in the way of their own due diligence. In many cases, the loan participations were bought on blind faith and unlimited optimism."

Although the OCC examinations voiced concerns about Penn Square's loan concentrations as early as 1977 and had bank officials sign agreements as early as 1980 to make changes, the issue came to a head in the spring and summer of 1982. With oil prices sinking, Penn Square's eventual failure started to become apparent.

As a part of its lender-of-last-resort function, the Kansas City Fed had extended credit through its Discount Window to Penn Square to keep the bank operational through the Independence Day holiday weekend. Meanwhile, Hoenig, who was then a vice president at the Kansas City Fed with responsibility for the Discount Window, spent the weekend talking with Fed staff in Oklahoma City to get information on Penn Square's loans and losses.

Ultimately, the Kansas City Fed called in its outstanding loan, and the FDIC declared Penn Square insolvent.

The impact was not limited to the bank in the Oklahoma mall. More than 50 banks had bought participations in Penn Square loans. Among those banks, Continental Illinois, then the nation's seventh-largest bank, collapsed two years later due, in part, to its exposure to Penn Square, and Seattle-First, with a push from Penn Square, was later declared insolvent.

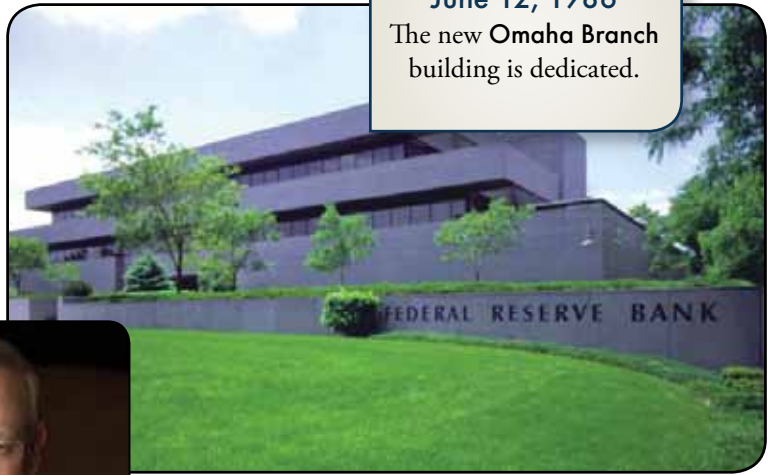
Penn Square was only the beginning. By the end of the 1980s crisis, 350 Tenth District banks would fail or receive assistance.

June 1, 1986

Hoenig assumes full responsibility for the Supervision and Structure Division and becomes a member of the Reserve Bank's Management Committee.

June 12, 1986

The new **Omaha Branch** building is dedicated.



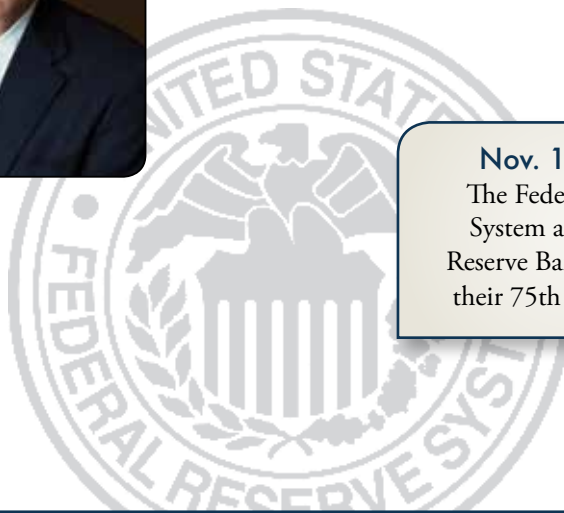
Jan. 1, 1986

Hoenig is named senior vice president in charge of examination, inspection and supervision activities in the Tenth District.



Nov. 16, 1989

The Federal Reserve System and Federal Reserve Banks celebrate their 75th anniversary.



1986

1987

1988

1989

1990

Aug. 8, 1987

Alan Greenspan becomes Federal Reserve chairman.



Oct. 19, 1987

Known as **Black Monday**, markets worldwide tumble and the Dow Jones Industrial Average sheds more than 20 percent of its value, falling 508 points to 1,738.74.



1989

The number of **financial institution failures** in the late 1980s and early 1990s peaks as total of 533 banks and savings and loans fail. From 1988 through 1992, an average of one bank or S&L failed in the United States every day. In the Tenth Federal Reserve District, more than 300 banks failed during the 1980s, or about 11 percent of the District's 1980 banking population.

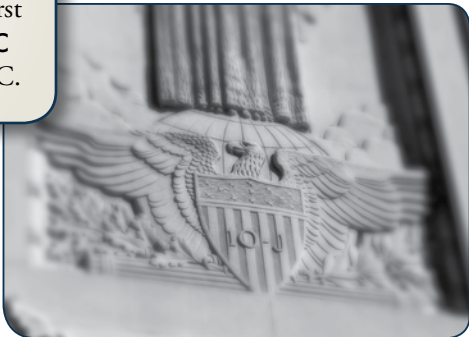
July 1990

U.S. economy **enters a recession**.



Oct. 1, 1991
 Hoenig takes office as president of the Federal Reserve Bank of Kansas City, spending his first day on the job at an **FOMC** meeting in Washington, D.C.

Aug. 13, 1991
 The Reserve Bank's Board of Directors announces that Hoenig will be the **eighth president** of the Federal Reserve Bank of Kansas City.



• **1991** • • • • • **1992** • • • • • **1993** • • • • • **1994** • • • • •

March 1991
 U.S. economy **exits a recession.**



March 10, 1993
 Federal Reserve Bank presidents are called to testify before the **Senate Banking Committee** on their role as members of the Federal Open Market Committee, including voting on monetary policy.

December 1994
 Devaluation of the Mexican peso starts the **peso crisis.**



“What I am suggesting is for us to focus on the issue of systemic risk by placing an emphasis on efforts to strengthen the ability of the financial system to cope with the failure of individual institutions.”

— Thomas Hoenig, “Rethinking Financial Regulation,”
Feb. 2, 1996, Davos, Switzerland

March 25, 1999

In a speech titled “Financial Industry Megamergers and Policy Challenges,” President Hoenig warns about the dangers being created by a wave of financial services sector mergers.

Feb. 2, 1996

In a speech titled “Rethinking Financial Regulation,” President Hoenig focuses on issues such as **systemic risk** and the moral hazard created by the safety net available to banks.



1995

1996

1997

1998

1996

The **Check Processing Control System**, which automates check balancing and proof processes, is introduced, improving efficiency in payments.

July 1997

Thailand’s baht currency collapses, beginning the **Asian financial crisis**.



April 6, 1998

Citicorp and Travelers Group announce their merger. The joining of the massive bank and the financial services firm creates the world’s largest financial services organization under the Citigroup banner. Although laws in place since the Great Depression blocked banks from entering businesses such as those done by Travelers, Citigroup officials say they are confident those laws will be overturned, which happens the following year.

Aug. 17, 1998

The **Russian government** devalues the ruble and defaults on its debt.



Sept. 23, 1998

The Federal Reserve Bank of New York organizes a **bailout** of the hedge fund Long-Term Capital Management. Critics said the New York Fed’s role in the bailout risked creating moral hazard.

“The easing of monetary policy during the past year has provided substantial liquidity to the financial system. In a recession, this is appropriate, as increased liquidity and lower borrowing costs help stimulate spending and assist in relieving financial stress for consumers and businesses. With the real cost of short-term borrowing near zero, however, going forward there is a risk that credit availability will become too easy. If so, one result could be an undesirable increase in the debt burden of households and businesses. Another possible outcome is a speculative increase in asset prices fueled by easy credit availability.”
 — Thomas Hoenig, *“The Economy in 2002: A Challenging Time for Monetary Policy,”* April 26, 2002, Omaha, Neb.

January 2002

The Federal Reserve Bank of Kansas City announces it is at work on a **new headquarters** project in Kansas City.



Apr. 26, 2002

In a speech titled “The Economy in 2002: A Challenging Time for Monetary Policy,” President Hoenig warns about the risks created by **exceptionally low interest rates.**

1999

Nov. 12, 1999

The **Gramm-Leach-Bliley Act** is signed into law, allowing firms to offer commercial banking, investment banking, insurance underwriting and brokerage services.

March 10, 2000

The **dot-com bubble** reaches its height with the Nasdaq peaking at 5,048.62—more than double what it had been a year earlier. The index begins a dramatic fall soon after. On Dec. 31, 2000, the index is down to 2,470.52 and 1,335.51 a year after that.

2000

April 2000

U.S. **unemployment falls** to 3.8 percent—its lowest level since December 1969.



2001

Aug. 30, 2002

Chairman Greenspan defends the Fed’s actions during the dot-com bubble, saying “the notion that a well-timed incremental tightening could have been calibrated to prevent the late 1990s bubble is almost surely an illusion.”

2002



June 6, 2005
Groundbreaking on the new Kansas City headquarters at 1 Memorial Drive.



Oct. 30, 2006
In a speech titled “This Time It’s Different (Or Is It?),” President Hoenig notes **similarities** between the current environment and the period prior to the 1980s banking crisis.

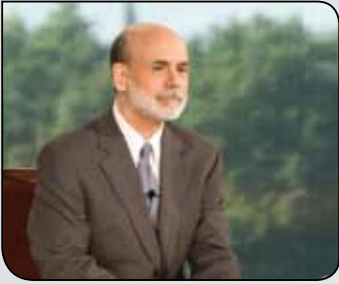
• • • **2003** • • • **2004** • • • **2005** • • • **2006** • • • **2007** • • •

June 25, 2003
The FOMC lowers its federal funds rate target to 1 percent, its lowest level since 1958, saying the economy had not shown sustainable growth and that the risk of deflation outweighs the risk of inflation. The rate stays at 1 percent until June 2004.

2004
The **Check Clearing for the 21st Century Act** takes effect, allowing the use of electronic image transfer for checks instead of shipping the original paper.

U.S. **homeownership peaks** at nearly 70 percent.

Feb. 1, 2006
Ben Bernanke becomes Federal Reserve chairman.



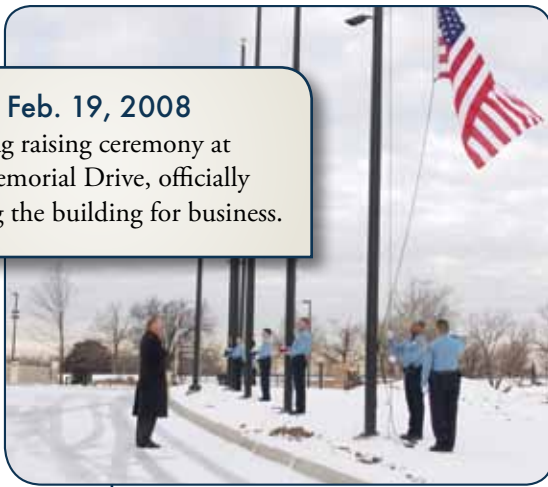
Mid-2006
A key index of U.S. **home prices**, the Case-Shiller Home Price Index, sets an all-time high.

Feb. 7, 2007
Pittsburgh, Penn.-based Metropolitan Savings Bank fails. It is the first failure of an FDIC-insured bank in almost three years. Two more banks failed in 2007.

Aug. 10, 2007
Amid growing concerns about **subprime mortgages** that included the failure of two large lenders, the Federal Reserve announces it “will provide reserves as necessary” to promote trading in the federal funds market, noting that “in current circumstances, depository institutions may experience unusual funding needs because of dislocations of money and credit markets.”

Feb. 19, 2008

Flag raising ceremony at 1 Memorial Drive, officially opening the building for business.



2010

President Hoenig **dissents** to each of the FOMC's eight policy votes, disagreeing with the majority opinion of holding the federal funds rate at 0 to 0.25 percent for an "extended period."

Jan. 25, 2008

Kansas City, Mo.-based Douglas National Bank fails. It is the first failure of a bank in the Tenth Federal Reserve District since 1999 and the first failure of a Kansas City-area bank since 1994. Nationwide, 25 banks fail in 2008, 140 in 2009 and 157 in 2010.



Oct. 1, 2011

Mandatory retirement of President Tom Hoenig.

March 6, 2009

President Hoenig delivers the speech "**Too Big Has Failed**" in Omaha, Neb.

March 25, 2011

Kansas City Fed Board forms a **search committee** for President Hoenig's successor

2008

2009

2010

2011

Oct. 9, 2007

The Dow Jones Industrial Average hits its **all-time high** of 14,164.53.

December 2007

The U.S. economy enters a **recession**.



Sept. 15, 2008

Lehman Brothers Holdings Inc. files for bankruptcy protection.

Oct. 3, 2008

President George W. Bush signs the Emergency Economic Stabilization Act of 2008 into law, establishing the \$700 billion **Troubled Asset Relief Program (TARP)**. It is one of several special programs undertaken by the Treasury and the Federal Reserve.

Dec. 16, 2008

The **FOMC** lowers the federal funds rate target to 0 to 0.25 percent in the fight against the recession and the financial crisis.

June 2009

The **recession** officially ends, according to the National Bureau of Economic Research.

October 2009

U.S. **unemployment** hits 10.1 percent—the highest level since June 1983.

July 21, 2010

The Dodd-Frank Wall Street Reform and Consumer Protection Act is signed by President Barack Obama.

Late 2010

U.S. **homeownership** reaches the lowest level in 13 years.



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The Federal Reserve System

Congress created the Federal Reserve in 1913 to bring financial stability after a number of banking panics. It is the nation's third central bank. The first, established in 1791, and the second, created in 1816, were each operational for 20 years. In both cases, its charter failed to be renewed and the banks closed.

With the Federal Reserve Act, Congress sought to create a central bank the public would be more likely to support by making it "decentralized" with more local control. This new structure was designed to overcome one of the primary weaknesses of the previous central banks: public distrust of an institution that many felt could potentially be under the control of either government or special interests. The new central bank is a network of 12 regional Federal Reserve Banks, located throughout the country and under the leadership of local boards of directors, with oversight from the Board of Governors in Washington, D.C., a government agency.

The Federal Reserve is considered to be independent within government and broadly insulated from political pressures. While members of the Board of Governors are nominated by the president of the United States and confirmed by the Senate, the Federal Reserve's regional structure, including local boards of directors and advisory councils, ensures that views from a broad spectrum of the public nationwide contribute to the central bank's deliberations.

President Woodrow Wilson signed the Federal Reserve Act on Dec. 23, 1913, and the 12 regional Federal Reserve Banks opened on Nov. 16, 1914.

The Federal Reserve Bank of Kansas City

The Federal Reserve Bank of Kansas City and its Branches in Denver, Oklahoma City and Omaha serve the Tenth Federal Reserve District, which encompasses western Missouri, Nebraska, Kansas, Oklahoma, Wyoming, Colorado and northern New Mexico. As a part of the Federal Reserve System, the Bank participates in setting national monetary policy, supervising and regulating numerous commercial banks and bank holding companies, and providing check processing and other services to depository institutions.



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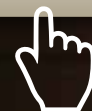
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