

# Opening Remarks

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Good morning, everyone. It is my pleasure to welcome you to Kansas City, to welcome you to the Federal Reserve Bank of Kansas City, and to our payments conference today where we will focus on consumer payments, innovation, and what we are calling the connected age. This is our fourth such conference on payments that we have hosted. It has certainly proven to be an important forum for policymakers, for industry leaders, and financial institutions—both in the United States and abroad as we talk about emerging issues facing the payments system. I expect this year's event, which focuses on the role of the consumer, is going to continue in that tradition.

Certainly we live in an increasingly connected world. Smartphones and social networks are allowing us to exchange information with each other more freely, more quickly, and from a wider variety of locations. This increased connectedness has important implications for our society and for our economy. So we have designed this conference to focus on the questions of how these developments will affect the consumer in the days ahead.

The Federal Reserve, I believe, should take a strong interest in these developments in consumer payments. As part of its mission to promote economic growth and financial stability, the Federal Reserve has a mandate to foster the efficiency, safety, and accessibility of the payments system. Most people agree these are important and appropriate goals for the Federal Reserve.

Yet, as the payments system becomes more electronic, views will differ on how the Federal Reserve should go about achieving these goals. My own view is the central bank has a clear and compelling role in assuring the financial stability of the payments system. This responsibility has always and understandably included both wholesale and retail payments. Their safety and reliability, including reliability of access, are essential to the smooth functioning of the nation's payments and therefore its economy. Each involves significant volumes. Each involves the

efficient movement of goods and services, large and small, among individuals and businesses here and abroad. And importantly each involves trust.

Arguments that defend the Federal Reserve's role in wholesale payments apply equally to retail. Of course, wholesale payments involve clearing and settling trillions of dollars daily and while the dollar value of retail payments is substantially smaller, consumers and businesses are involved in a billion retail payment transactions every day. An interruption in the flow of this volume can easily affect the public's perception of the safety, reliability, and access of such payments.

Throughout its history, the Federal Reserve has played an important role as a retail payments operator, enabling it to bring about socially beneficial changes. In its early days, the Federal Reserve was deeply involved in standardizing check clearing practices across the country. The practice of non-par payment of checks resulted in tremendous inefficiencies. To avoid the charges imposed by some banks, checks would be sent on a meandering route through numerous institutions, resulting in delays of up to several weeks before final settlement. By offering par check clearing as one of its services to member banks, Reserve Banks address this problem, providing significant cost savings for commercial banks, fostering the development of the personal check as a popular payment method, and eventually achieving a truly national check system. This achievement led to a more efficient and accessible payments system by eliminating the circuitous routing of checks that had become a burden to both consumers and financial institutions.

Later the Federal Reserve's role as an operator helped it bring about other beneficial changes in check clearing, such as the adoption of high-speed check sorting equipment and the development of electronic check imaging that resulted in a more cost-effective, fully electronic clearing system for checks. As with its earlier check clearing efforts, the gains in efficiency provided by these innovations were obvious.

Today the Federal Reserve is developing applications to further streamline electronic check clearing. These new systems will allow the Federal Reserve to continue to meet its mandate under the Monetary Control Act, by enabling us to price services at levels competitive with the private sector.

We are also working with the United States Treasury to develop and implement technologies that improve the efficiency of the government's payment processes, producing important public benefits.

Even the proponents of a narrow role for the Federal Reserve in the payments system acknowledge that the central bank has played a critical role in the development of the automated clearinghouse—the first end-to-end electronic retail payment method. The ACH has become an important payments network, representing some 18 percent of noncash payments, according to one of our recent studies.

The Federal Reserve's operator role also has helped keep the payments system running smoothly in times of crisis. This was not only evident during the grounding of airplanes during terrorist attacks of 9/11, but also during banking crises over the past 30 years when the failure of financial institutions disrupted correspondent relationships.

Today the payments system is evolving in ways that further strengthen the case for the central bank to continue to play a key operator role in retail payments. A skeptical person might say there will not be agreement on the Federal Reserve's role until there is a crisis. Unfortunately, as history has demonstrated, we cannot avoid crisis situations.

The question is, How will the central bank be positioned to respond? I believe the Federal Reserve is obligated to be prepared as an operator, to facilitate payments in good times, and to backstop payments in times of crisis. Changes in commerce and technology are creating new risks to the payments system by providing criminals with novel ways to commit fraud quickly and on a large scale. In this environment, consumers and businesses could quickly lose confidence in the payment methods operated largely outside the banking system. To limit the economic damage from such events, the Federal Reserve could serve to ensure there is always a trusted way for consumers and businesses to pay each other through their banks. That backup payment method used to be checks. As checks decline, the need remains for a safe, efficient, and accessible alternative.

Increased fraud and privacy risk are not the only reason for the Federal Reserve to maintain its operator role in retail payments, though. Many new payment methods have appeared in the last few years and others are likely to emerge in the years ahead. As we look at person-to-person payments, for example, we see a fragmented market that limits the benefits consumers enjoy from the pay-anyone-anywhere ubiquity of the check instrument.

As network economies allow one of the new P2P methods to dominate, a concentrated market may deliver higher prices, restricted access, and slower innovation. By staying involved in retail payments as an operator and by offering a competitively priced end-to-end product, the Federal Reserve may help avoid these adverse outcomes.

Finally, of the various roles the central bank can play in retail payments, my view is the role of regulator should be limited. My strong preference is for market forces to guide the evolution of retail payments. However, where the market falls short in achieving safety, efficiency, or access goals, the Federal Reserve can aid these forces in its role as an operator, identifying services that are valued by its customers, and competing fairly and pricing its services to recover its costs, as we do under the Monetary Control Act.

As an operator, the Federal Reserve is also well-positioned to serve as an industry catalyst, such as by hosting this conference in order to bring together and collaborate with market participants and industry experts to ensure the retail payments system continues to meet the needs of consumers and ultimately to support economic growth.

Again, I welcome you to today's conference. I thank you for being part of this program, and I certainly look forward to our upcoming discussions. Thank you.