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Update On Federal Reserve Bank Operations

Remarks by

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at

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Thank you for the opportunity to speak to you today.¹

What I want to talk about is central bank independence but applied to Reserve Bank operations. The decentralized and regional design of the Federal Reserve helps reinforce our independence by ensuring that the full range of interests and views are represented in policy discussions, and that is something that should be preserved. But much of the day-to-day operations of the Reserve Banks are not connected to monetary policymaking, and I recently gave a speech at the Brookings Institution where I suggested some improvements to the efficiency of Reserve Bank operations. I believe that these improvements would keep the Fed's commitment to wisely use public resources in serving the American people and thus help support our independence in conducting monetary policy in the public's interest.

In that speech I asked two questions: First, what are the functions and activities that are unique to a Reserve Bank District and need to be done by a Reserve Bank in a manner tailored to the local economy and local needs? Second, what functions and activities can be done anywhere, and in fact can be done better and more efficiently if standardized across the entire Federal Reserve System?

The first question addresses functions where geography matters. The second focuses on functions for which geography does not matter.

It is clear that there are responsibilities that belong in a District and, to be true to the genius of the Federal Reserve's design, locally run: The Presidents vote on monetary policy, having a research function to aid the President, community outreach, community development, supervision, and discount window operations.

¹ The views expressed here are my own and are not necessarily those of my colleagues on the Federal Reserve Board or the Federal Open Market Committee.

But I noted in my speech that most System employees are engaged in operations, providing critical services to the banking system, the U.S. Treasury, and, ultimately, the American public. Information technology (IT), human resources, financial management, enterprise risk management, and payments are essential to achieving those operational outcomes. But there is no obvious rationale to do these things in 12 different ways. These are certainly services needed by each Reserve Bank, but they do not need to be provided by each and every Bank. These are functions that can be done in a standardized or even centralized way and provided uniformly at scale across the System. The System, and ultimately the taxpayer, benefits from lower operating costs and better overall risk management, with services delivered consistently across the Reserve Banks.

So I proposed centralizing and standardizing back-office functions and having the Reserve Banks focus on the things they uniquely provide to their Districts.

Toward that end, the presidents have developed a framework that shows how to reap the risk and efficiency benefits of standardization and centralization. I want to applaud their efforts. It is a tremendous step forward for the Federal Reserve System.

After I gave that speech, I have heard several comments that my proposal was somehow at odds with the fundamental, and time-tested, design of the Federal Reserve Act with its emphasis on regional perspective and Reserve Bank independence.

So let me address that concern.

The Federal Reserve System was designed as a federated system, expressly to meet the needs of a large and diverse country while avoiding the concentration of too much power of influence in places like Washington and Wall Street.

The 12 Reserve Banks were designed to carry out most of the nonmonetary policy functions and services with oversight by the Board of Governors. In this sense, the Reserve Banks are able to make largely independent decisions on operations while being accountable to the Board and the American public. Day-to-day control is not exercised in Washington but by the Reserve Banks. This is how they have operated since the beginning of the Fed.

But technology and legislative changes are driving us to rethink how we provide those services in a cost-efficient manner. How do we exploit those efficiencies while maintaining the spirit of regionalism and Reserve Bank independence that is at the heart of the Federal Reserve Act?

The presidents have answered that question by developing a framework that has the Reserve Banks make independent decisions as a collective group, as opposed to making decisions on a bank-by-bank basis. There is still oversight of these decisions by the Board of Governors but it is just that—oversight, not decisionmaking. Regionalism is preserved via the activities I listed above that are unique to each District and ensures that the spirit of the Federal Reserve Act is maintained.

Functions such as human resources will be centrally led by a single Reserve Bank who will then act like a “contractor” for the rest of the Reserve Banks to provide HR services with appropriate service-level agreements. Accountability is strengthened in the process. But the Reserve Bank responsible for a particular function will have the authority to allocate resources to operate in a cost-efficient way that achieves operational excellence for the System as a whole. Individual Banks must give up day-to-day decision rights over how the “contractor” Bank provides those services. The Board will maintain

its oversight role to ensure that performance meets service expectations and costs are appropriate. But the key element of this design is that the Reserve Banks still have control over all operations—their operational independence is not diluted in this framework. Further, the presidents’ plan distributes key responsibilities across the System, so that each Bank contributes in a manner consistent with its local expertise and capacity to the benefit of the System as a whole.

But to make this new framework effective, as a collective group tasked with improving operations and at a lower cost, there has to be a change in mindset and a governance change. Bank presidents and first vice presidents need to adopt a “System first, Bank second” mindset. This is a change in mindset that I have been pushing since I was given my oversight role in 2022. Historically, there tended to be a “Bank first, System second” philosophy, which was fine when everything was done locally. But times have changed and so must our mindset.

What also needs to change is the governance model. While striving for consensus is a great model for making difficult policy decision, it is not obviously successful when running complex and critical operations. Otherwise, one Bank can halt actions that are needed to move the System forward. Again, in the past, this was not uncommon. But moving to a model where consensus is not the modus operandi will require rethinking how decisions get made for the System. Banks will need to give up day-to-day control of many parts of their operations and delegate decisionmaking to a single Bank. That requires collective trust in the contractor Bank and a commitment by that Bank to deliver the services needed by all the other Banks.

To conclude, over the last six months, the Board and the Reserve Banks have moved rapidly toward developing an approach that I am confident will modernize our operations to be more efficient while enhancing service delivery. There are still details to be worked out and all of us who play a role in System leadership understand the complexities of change management and execution. That is especially true given the criticality of the services that are provided by the Reserve Banks, including moving trillions of dollars in payments every day for commercial banks and the U.S. Treasury. But the foundation is now in place for driving an important transformation, and I look forward to working with all of the Reserve Bank presidents and first vice presidents to move this framework forward.