Video Transcript

Narrator: Every day...around the world... millions of financial transactions take place. In fact, during this short program, billions of dollars in electronic transfers... checks... and cash will move from one person, business, or financial institution to another. Fortunately, this transfer of money generally flows smoothly and, except by those directly involved, goes unnoticed. However, on September 11, 2001, the unexpected and the unimaginable happened.

One consequence of this event was the damage to a complex web of financial connections. During this time of financial vulnerability, the Federal Reserve System acted decisively and quickly to help stabilize our nation's economy.

Pause Here

Narrator: The Federal Reserve System, or the Fed, was created by Congress in 1913. Its purpose was to serve as the central bank of the United States. And, its primary mission at that time was to ensure and safeguard against bank panics. Over the years, the Fed's responsibilities have evolved. They now include monitoring our nation's payments system of electronic money transfers, checks, and cash; regulating banks for safety and soundness; and implementing monetary policy to promote a healthy economy and price stability. These roles of the Fed were put to the test on the days following September 11.

Narrator: On the morning of the eleventh, while Fed Chairman Alan Greenspan was on a return flight after meetings in Switzerland, Vice Chairman Roger Ferguson coordinated the Fed's response from Washington, D.C.

Vice Chair Ferguson: "On the morning of September 11, 2001, I was sitting at my desk starting another business day. I got a phone call shortly before nine o'clock indicating that one of the towers at the World Trade Center was on fire. I turned on the TV to gather as much news as I possibly could and saw with horror and shock the second plane go into the second tower.

I then had a chance to look out of a window and saw smoke coming from the direction of the Pentagon. It was clear at that time that there was a major problem underway and that it looked as though there would be a number of issues and challenges that the U.S. would be confronting. Obviously, significant loss of life in New York and Washington was high on everyone's mind, but with respect to the Federal Reserve, the main issue had to do with the financial system."

Narrator: In times of crisis, like 9-11, people need faith in their nation's financial system. One way to strengthen this faith is to provide liquidity, which simply refers to the availability of money. And, to show that it was ready to offer the monetary assurance people and financial institutions needed, the Fed issued a short, yet important, statement: "The Federal Reserve System is open and operating. The discount window is available to meet liquidity needs."

Video Transcript

In the days that followed, the Fed helped to maintain calm in the financial markets through its three main functions: the payments system, banking supervision and regulation, and monetary policy.

Narrator: On Tuesday, September 11, the Federal Reserve monitored an intricate structure of financial connections called the payments system. Basically, the payments system refers to the Fed's roles in transferring money, or payments, from one bank to another. This is done either as electronic money transfers, checks, or cash.

Preventing failures in the payments system was an immediate concern of the Fed, since a blockage in any area could cause a gridlock throughout the entire network. A gridlock that had the potential to affect the financial markets and the economy.

A critical component of the payments system is Fedwire. This is a large-dollar electronic service that banks use to transfer payments to one another and to settle customer transactions. On an average day in 2001, Fedwire originated electronic transfers of about 1.6 trillion dollars. And, on Tuesday morning – September 11 – with the exceptions of a few disruptions in New York, Fedwire was running smoothly throughout the country. Knowing that Fedwire was operating as it should, the Fed next turned its attention to the money supply.

John Moore: "Well once we knew that Fedwire was up and running, our attention immediately turned to the cash area. And the reason for that is that it's very normal in a crisis situation or a natural disaster for the general public to want to go out and get their hands on as much cash as possible, and so we wanted to make sure that we were in a situation where plenty of cash was available to the banks and they in turn could make it available to their customers in order to avoid any kind of a panic situation."

☞ **Narrator:** In Manhattan, all bridges and tunnels were closed, and the Fed was concerned that automated teller machines might run out of cash. To meet this potential shortage, the Federal Reserve Bank of New York immediately made special arrangements with New York City Police and New Jersey State Troopers. The purpose: to deliver more than 425 million dollars to local banks.

John Moore: "Well the first thing that we did was we told our customers don't worry about the usual schedule for ordering cash. Normally we would ask our banks to order by noon today in order for a delivery to arrive to them tomorrow. But we told them to forget about that in this situation because, after all, there was nothing normal about that particular day."

Video Transcript

Narrator: However, Fedwire and cash weren't the only concerns. The Fed also wanted to do whatever it could to process checks in a timely fashion. On a typical day, the Fed processes one-third of the total checks written in the U.S. This means that in 2001 approximately 55 million checks a day were delivered by ground and air transportation to the Fed's various processing sites. However, when air traffic was shut down, the Fed immediately began working on alternative methods of ground transportation.

Rich Oliver: "Float is the amount of money that's been credited to the accounts of depositing banks that has not yet been debited to the accounts of check writers across the country. In the days following 9-11 in order to maintain confidence in the check collection system, we continued to credit depositing banks according to normal schedules. We did this knowing full well that for inter-territory items that required air transportation we would not be able to collect those checks on time. In fact, on the twelfth of September we incurred somewhere around 23 billion dollars worth of float, which is about 30 times our historical daily average. This 23 billion dollars represents the liquidity that we provided for the payments system."

Pause Here

Narrator: Fedwire, cash, and check clearing...during the crisis the Fed carefully monitored and adapted these three payment methods to help stabilize the economy and maintain liquidity. But the Fed still had more to do. Another primary function of the Fed is to act as a banking supervisor and regulator, overseeing the safety and soundness of the U.S. banking industry.

Richard Spillenkothen: "Our initial reaction to the events of September 11 was really to open up an ongoing, continuous dialogue with the other regulatory authorities, the office of the comptroller of the currency, the FDIC, the SEC, and the Office of Thrift Supervision. Our objective was to understand the impact of these events on the financial system, both from an operating risk standpoint and a liquidity and financial standpoint. Within two or three days into the extraordinary events, we began to see the potential for imbalances in bank balance sheets, due to inflows of deposits or to extraordinary credit demand, or other transactions that did not clear as initially expected.

As we saw the potential for this occurring, the regulatory authorities issued a statement to the banking industry, to the financial industry really, indicating that they should work with their customers, and as they saw these imbalances build up on their balance sheets, to communicate effectively with their regulatory authorities, so the authorities could understand the impact of events of 9-11 on the financial system and help us understand that and work with the organizations we supervise, as they work through this very difficult and extraordinary period."

Video Transcript

Narrator: In the days after 9-11, the Fed used its monetary policy tools to ensure that financial institutions would have the liquidity, or money, they needed.

Ferguson: "Our financial system is extremely efficient at maintaining liquidity. It brings together providers of funds and borrowers of funds with very little government intervention, and often that is taken for granted. Unfortunately, on September 11 it could not be taken for granted. There were severe disruptions in market infrastructure, financial institutions, and unfortunately the people who work in them. It was a time when the Federal Reserve had to step in and provide ample liquidity. We did so using all of the mechanisms available to us at the time."

Narrator: Typically, the incoming and outgoing payments of banks across the country balance one another. However, the events of 9-11 meant that some banks were unable to make or receive their payments. This had a domino effect that caused some banks to run huge positive balances, and others to run negative balances. They needed to find other sources of liquidity before the close of business. To help alleviate this situation, the Fed used one of its monetary policy tools, loans at the Discount Window. At the Discount Window, the Fed lends money to banks typically overnight to help them maintain smooth day-to-day operations. On a normal business day, in 2001 these loans totaled about 54 million dollars. But on September 12, the Fed lent a record 46 billion dollars.

☞ **Narrator:** But U.S. banks weren't the only concern. The Fed also wanted to make sure that foreign financial institutions would have sufficient dollars on hand to support their needs. To help achieve this, on September 12, the Fed entered into agreements with the European Central Bank and the Bank of England, and augmented an existing agreement with the Bank of Canada. These agreements, or swap lines, allow foreign central banks to exchange their currency for an equivalent amount of U.S. dollars. The European Central Bank drew on its swap line and was then able to provide dollars to banks in much of Europe. In turn, this enabled their customers, both businesses and individuals, to meet their financial obligations.

Another tool the Fed uses to control liquidity is Open Market Operations. Every day, the trading desk at the Federal Reserve Bank of New York enters the market to buy or sell Treasury securities. If the Fed buys securities, money is put into the banking system – thus increasing liquidity. Conversely, if the Fed sells securities, money is taken out of the banking system.

In the days after 9-11, the Fed wanted to increase liquidity and thus began buying securities in record amounts. On an average day in 2001, Open Market Operations injected between 2 and 8 billion dollars into the banking system.

Video Transcript

But on Wednesday, September 12, the Fed injected 38 billion dollars, more than double the previous record. On Thursday, the Fed shattered that mark with 70 billion dollars, and the day after that, the Fed injected even more – 81 billion dollars. What the Fed did, in effect, was satisfy ALL of the demand for liquidity generated by financial institutions. This calmed the markets.

Pause Here ☞

Jamie Stewart: "The New York Fed is located two blocks from the World Trade Center, so the safety of our people was our first concern, and fortunately we were able to get through that very difficult and chaotic period without any injuries to the people that work here. Our next concern was to keep the important functions of this bank going, including a major payments operation. People stayed overnight and into the second day to keep those operations going without a single interruption, and a large number of people then moved to our backup site later in the week and we were able to continue on into the next week without any stoppage at all in the important functions of this bank."

Narrator: On Monday, September 17, the Federal Open Market Committee – the monetary policy making body of the Fed – voted to lower the federal funds rate to increase liquidity even more. The federal funds rate is the interest rate that banks pay when they borrow money from one another. During the remainder of the year, the rate was reduced three more times to one and three-quarters percent – the lowest level in 40 years.

Ferguson: "The FOMC met on the morning of September 17. We started with a moment of silence in honor of those who had died on September 11. It then took the committee about 25 minutes to take the decisive action to cut the federal funds target rate by 50 basis points or half a percentage point."

Narrator: And the result of the Fed's activities? When the markets opened the following Monday, the payments system was operating smoothly, the necessary liquidity had been injected into the economy, and financial institutions were cautiously optimistic. September 17 marked the largest trading volume ever on the New York Stock Exchange in a single day – over 2 billion shares. The financial system was returning to normalcy. And "normal" for the Fed means operating 24 hours a day, 365 days a year. Of course, times of crisis, such as the days following 9-11, are no exception. The destruction of the Twin Towers created unprecedented challenges for the financial community. And, for the Fed, the events placed enormous pressure on the payments system and the financial markets.

But the Fed was prepared to meet this challenge...to address whatever needs might arise and to instill confidence in the global financial community. Even under the burden of this tragedy, the U.S. economy proved to be resilient. Money was available for those who needed it, and our financial system continued to function normally. In short, the Fed showed the benefits of a well-functioning central bank.