

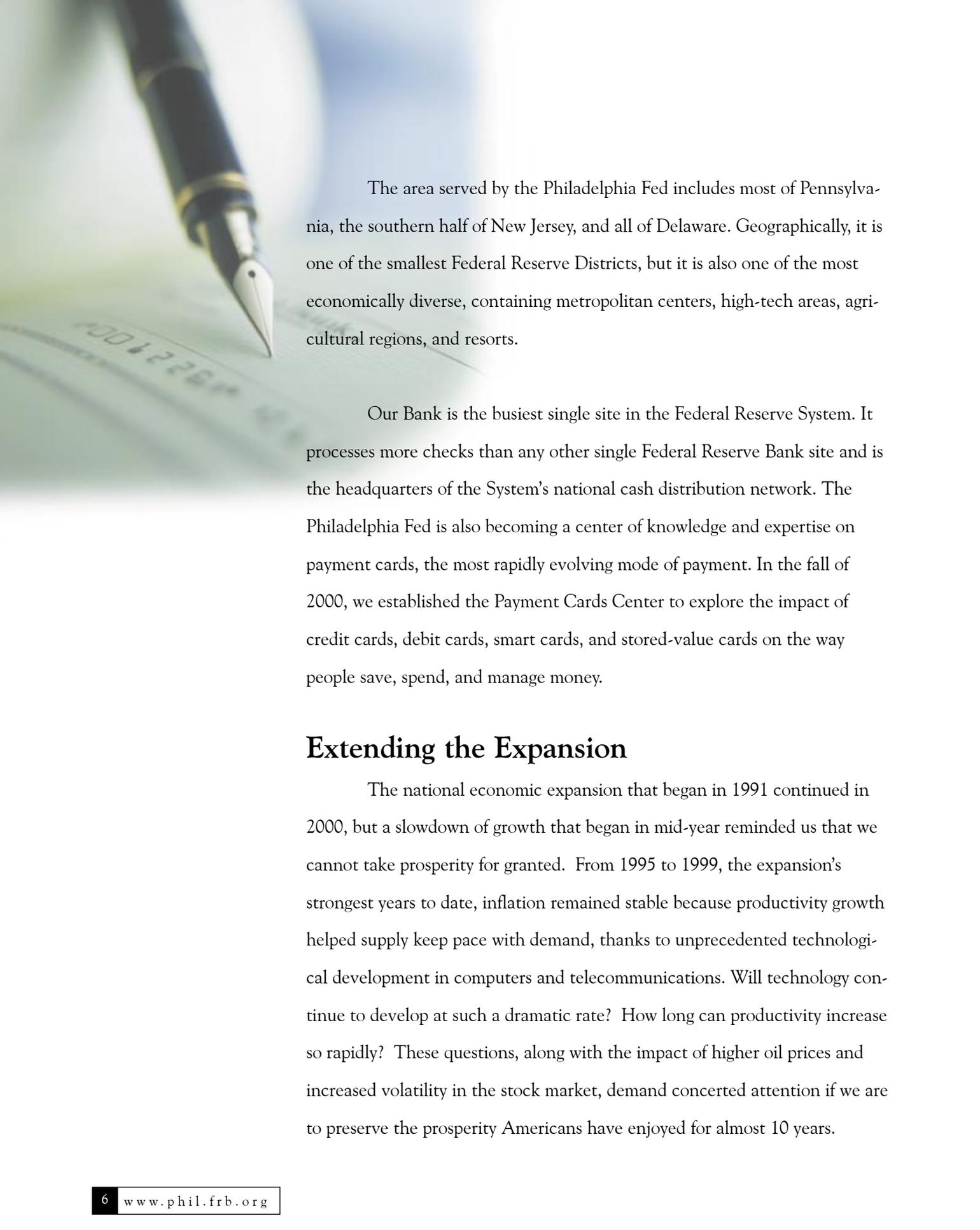
# President's Letter

With this Annual Report, we at the Federal Reserve Bank of Philadelphia would like to reintroduce ourselves to the broad business community of the Third Federal Reserve District. Many of you know us well, whether you are bankers, business leaders, students of economic policy, or individuals who have had contact with us through our community and public affairs activities. Others of you may have only a passing familiarity, and some may not know the Philadelphia Fed at all.

Yet, we interact with each of you in the tiniest details of daily life. Each ATM withdrawal, every check written, whenever change is made, the Federal Reserve helps to complete the transaction. We are the largest financial institution in the region, and our 1300 employees play a fundamental role in the region's economic life. We want people to better understand what the Federal Reserve is and what it does. Toward this end, we highlight our mission and functions in this year's Annual Report. Let's begin at the beginning...

## The Nation's Central Bank

As the central bank of the United States, the Federal Reserve System has one main purpose: to cultivate a financial environment conducive to the greatest sustainable economic growth and employment. The 12 Federal Reserve Banks located throughout the country, under the direction of the Federal Reserve Board in Washington, D.C., pursue activities in three areas: they establish and implement national **monetary policy**; they **supervise and regulate** banking and other financial services; and they ensure the efficient operation of the **payments system**.



The area served by the Philadelphia Fed includes most of Pennsylvania, the southern half of New Jersey, and all of Delaware. Geographically, it is one of the smallest Federal Reserve Districts, but it is also one of the most economically diverse, containing metropolitan centers, high-tech areas, agricultural regions, and resorts.

Our Bank is the busiest single site in the Federal Reserve System. It processes more checks than any other single Federal Reserve Bank site and is the headquarters of the System's national cash distribution network. The Philadelphia Fed is also becoming a center of knowledge and expertise on payment cards, the most rapidly evolving mode of payment. In the fall of 2000, we established the Payment Cards Center to explore the impact of credit cards, debit cards, smart cards, and stored-value cards on the way people save, spend, and manage money.

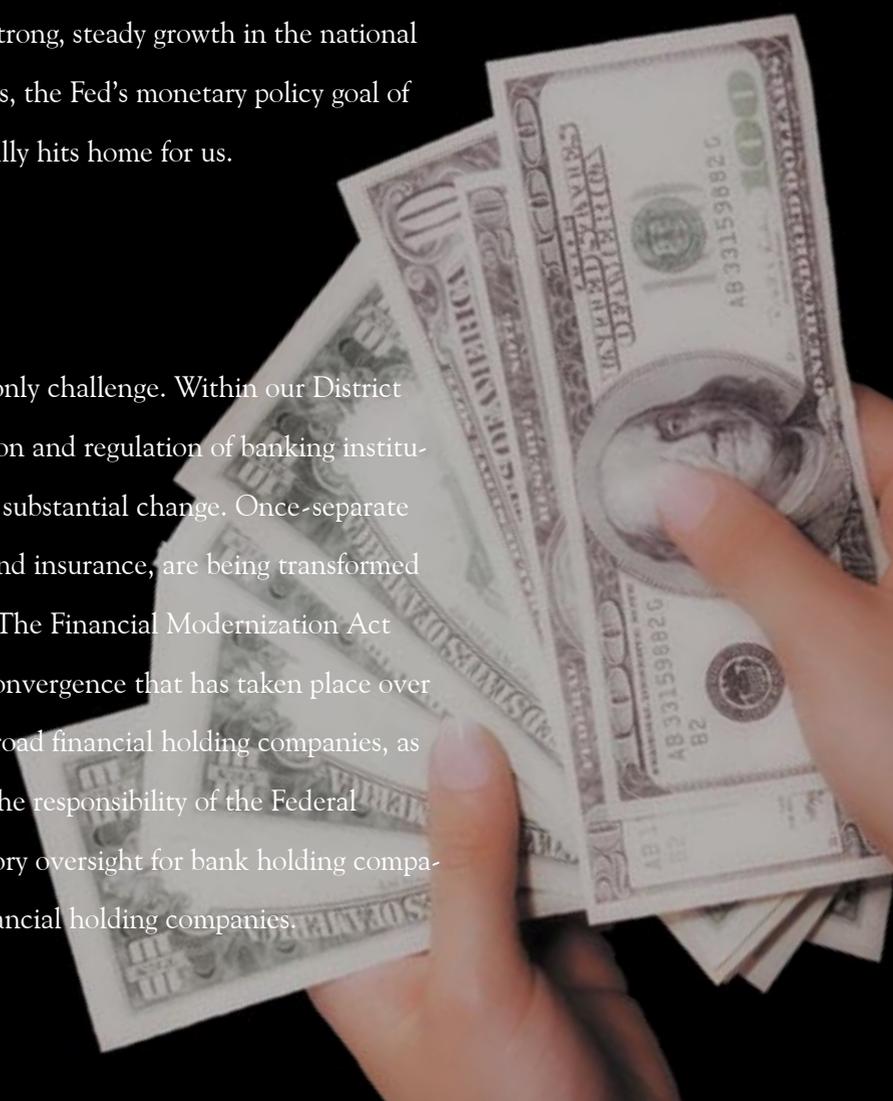
## Extending the Expansion

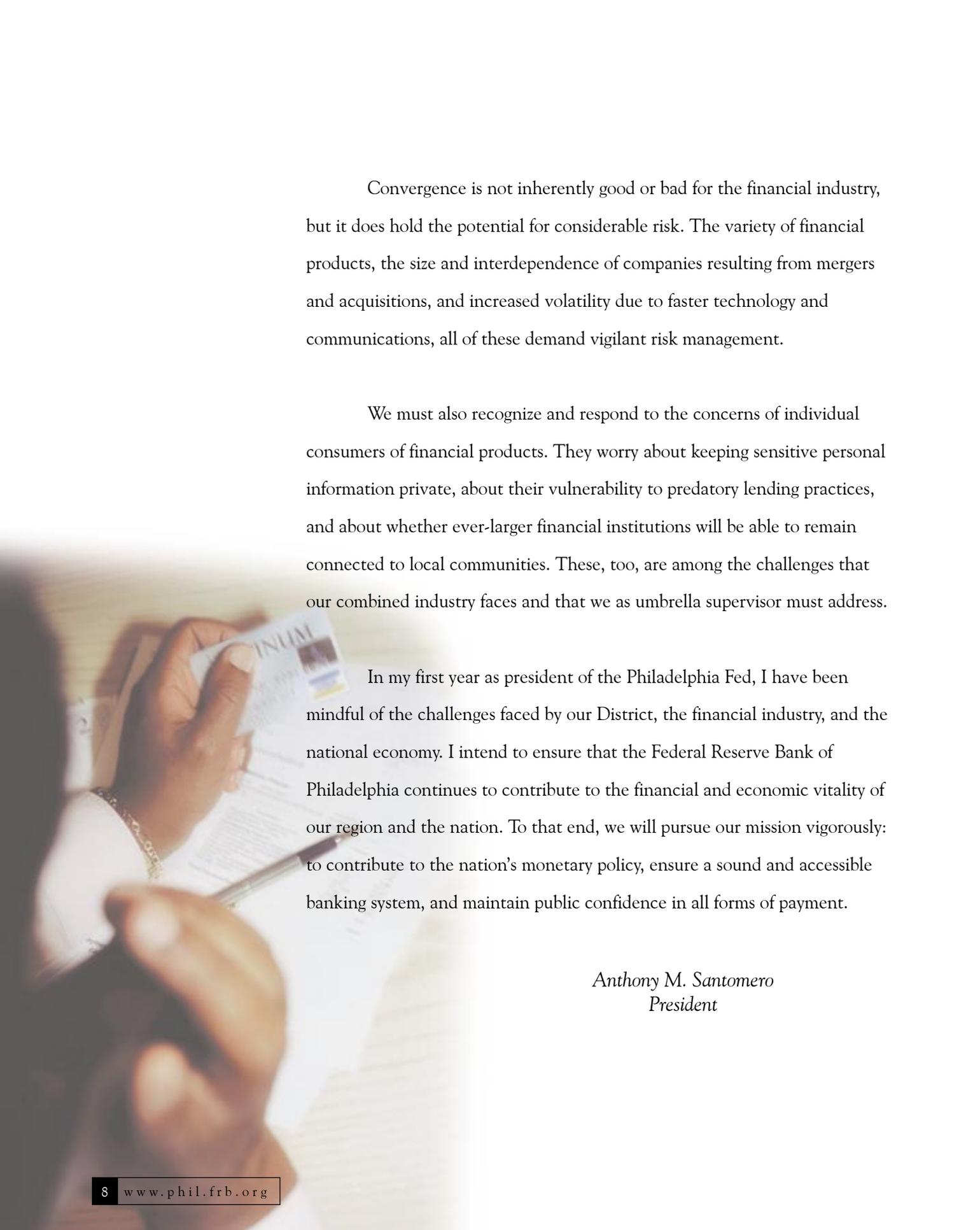
The national economic expansion that began in 1991 continued in 2000, but a slowdown of growth that began in mid-year reminded us that we cannot take prosperity for granted. From 1995 to 1999, the expansion's strongest years to date, inflation remained stable because productivity growth helped supply keep pace with demand, thanks to unprecedented technological development in computers and telecommunications. Will technology continue to develop at such a dramatic rate? How long can productivity increase so rapidly? These questions, along with the impact of higher oil prices and increased volatility in the stock market, demand concerted attention if we are to preserve the prosperity Americans have enjoyed for almost 10 years.

This unprecedented period of national prosperity has brought steady economic growth and low unemployment to our District. Activity has expanded across the board, particularly in such key sectors as business services, construction, and tourism. We continue to build on our reputation as a center for pharmaceutical research and production, health care, and higher education. And we are experiencing encouraging growth in bioengineering, communications, computers, and Internet companies. But, despite all of this good news, the Third District is not a high-growth area. Ours is a mature economy that relies heavily on strong, steady growth in the national economy to keep us moving ahead. Thus, the Fed's monetary policy goal of fostering sustained economic growth really hits home for us.

## Challenges of Financial Convergence

But monetary policy is not our only challenge. Within our District the Bank is responsible for the supervision and regulation of banking institutions that are themselves going through substantial change. Once-separate industries, such as banking, securities, and insurance, are being transformed into a broad financial services industry. The Financial Modernization Act (Gramm-Leach-Bliley) formalized the convergence that has taken place over the last 10 years. Supervision of these broad financial holding companies, as the resulting entities are now called, is the responsibility of the Federal Reserve, which has been given supervisory oversight for bank holding companies, including those that operate as financial holding companies.





Convergence is not inherently good or bad for the financial industry, but it does hold the potential for considerable risk. The variety of financial products, the size and interdependence of companies resulting from mergers and acquisitions, and increased volatility due to faster technology and communications, all of these demand vigilant risk management.

We must also recognize and respond to the concerns of individual consumers of financial products. They worry about keeping sensitive personal information private, about their vulnerability to predatory lending practices, and about whether ever-larger financial institutions will be able to remain connected to local communities. These, too, are among the challenges that our combined industry faces and that we as umbrella supervisor must address.

In my first year as president of the Philadelphia Fed, I have been mindful of the challenges faced by our District, the financial industry, and the national economy. I intend to ensure that the Federal Reserve Bank of Philadelphia continues to contribute to the financial and economic vitality of our region and the nation. To that end, we will pursue our mission vigorously: to contribute to the nation's monetary policy, ensure a sound and accessible banking system, and maintain public confidence in all forms of payment.

*Anthony M. Santomero*  
*President*