

PRESIDENT'S MESSAGE

In last year's annual report, I said we cannot take prosperity for granted. On September 11, 2001, this statement gained new meaning. As unimaginable events unfolded before our eyes, we trusted in the organizational design of the Federal Reserve System and the effectiveness of our crisis management plans. The Fed's actions following the attacks illustrate just how this structure responds to a national need. Now, more than ever before, the Fed is looked upon as a bastion of stability.

Reflecting on 2001, we see a year of progress and of challenges for the Federal Reserve Bank of Philadelphia. Our progress was evident in the expansion of the Bank's role in both our Third District communities and in the Federal Reserve System. Among our challenges were those shared by all — an economic slowdown and a national crisis. But above all, we remain committed to the long-term health of our region's and nation's economies. In this year's annual report, we share insights from the various Philadelphia Fed people who, in the aftermath of September 11, were instrumental in our ability to maintain "Stability in a Crisis."

ROLE OF THE FED & CRISIS MANAGEMENT

The Federal Reserve's mission is to provide money and credit conditions that foster maximum sustainable economic and job growth in an environment of price stability. This mission is achieved through three important and intertwined functions: conducting the nation's monetary policy, supervising and regulating banking operations, and providing and maintaining an effective and efficient payments system. One issue, however, remains paramount — maintaining public confidence in the nation's financial and economic system. This was never more evident than on September 11.

Our response was a coordinated effort across all three of our areas of responsibility. From keeping the payments system operating, to providing access to credit, to implementing monetary policy, the Fed proved vital in upholding the integrity of our financial system. We were able to simultaneously feel the pulse of financial activity across the country, operate in multiple locations, and



coordinate efforts to ensure financial stability.

Throughout the crisis, Fed operations continued. Employees at the Philadelphia Fed did a tremendous job in responding to a national tragedy. The dedication of Philadelphia Fed employees allowed us to remain open and operating in the aftermath of the attacks and ensured that the payments system was functional throughout the crisis. I commend all our Bank employees for their hard work and long hours during this especially troubling time for our nation.

STRATEGIC GOALS — 2002 AND BEYOND

Looking beyond the literal interpretation of our roles, we must strive to build our capabilities and achieve our goals. Doing so demands vision. At the Federal Reserve Bank of Philadelphia, our vision is to be known as an

important center of central bank knowledge and capability. Our strategy for 2002 and beyond is to be a high quality provider of central bank knowledge and services with emphasis on efficiency, innovation, and strong financial controls.

To achieve our goals, we must expand our knowledge of the broader financial services industry. Barriers into this industry have been eliminated for many nonbank and bank participants. With the emergence of new entrants, new vehicles for retail payments have emerged as well. The Payment Cards Center was created to address these issues and serve as a source of knowledge and expertise on this important segment of the financial system. Established in early 2001, the Center provides meaningful insights into the industry through an agenda of research and analysis, forums, and conferences that will encourage a dialogue incorporating industry, academic, and public-sector perspectives.

We must also continue to expand our outreach to academia, the financial services industry, and the community. This will be accomplished through monetary policy research, increased regional involvement, and Community and Consumer Affairs initiatives. Working with partners, we already have implemented a successful pilot financial literacy program in a Delaware high school. Next, we plan to expand financial literacy throughout the region.

Furthering our outreach efforts in 2001, our Bank had the privilege of hosting on separate occasions Chairman Alan Greenspan and Vice Chairman Roger Ferguson from the Board of Governors to speak to business leaders in our District. Another notable visitor to speak at our Bank was Lawrence Lindsey, President Bush's Assistant for Economic Policy, who offered insight on the effects of Bush's tax cuts on the economy.

The Philadelphia Reserve Bank is committed to enhancing its role as a prominent System leader. As a first-tier Bank in terms of quality, efficiency, and controls, Philadelphia is poised to be an integral part of the leadership process. In 2001, we acquired the SCRRM (Subcommittee

on Credit, Reserves, and Risk Management) office, which oversees discount window operating procedures on a System-wide basis. We have also earned a central role in the Fed's technology initiatives through our Groupware Leadership Center. This office coordinates desktop standards for the entire System.

The Philadelphia Fed held its inaugural Policy Forum last fall. This effort brought together a group of highly respected academics, policymakers, and market economists for a discussion of current macroeconomic research and its implications for monetary policy. The event, which garnered extensive media coverage, was considered a tremendous success.

As the leader in check processing, the Philadelphia Fed

actively seeks innovative solutions for improving its business. Our initiatives have included the development of check imaging to enhance the efficiency of the payments system, as well as a pilot program of sophisticated techniques to combat check fraud. Philadelphia also helps manage federal check payments. We are currently developing and managing checkbook software applications for the federal government. In addition, we serve as a primary collection point for U.S. Treasury checks.

THE ROAD TO RECOVERY

Looking forward, I see 2002 as a turnaround year for the economy. Thanks to the progress we have made in recent years, the Greater Philadelphia region will recover along with the nation. As I reported to you a year ago, activity in our region has continued to expand in such key sectors as business services, construction, and tourism. We also continue to build on our reputation as a center for pharmaceutical research and production, health care, and higher education. In both our region and the nation, we hope to see a healthy pace of sustained growth by year-end 2002. But first, our challenge is to manage the current period of economic weakness with an eye to the future. Our flexible markets, entrepreneurial spirit, well-educated work force, and major advances in information technology provide a

OUR VISION IS TO BE BROADLY RECOGNIZED AS AN IMPORTANT CENTER OF CENTRAL BANK KNOWLEDGE AND CAPABILITY.

sound foundation for the long-term growth of productivity, employment, and standards of living. While consumer and business behavior will significantly affect the progress of our economy in the near-term, the longer-term prospects for the U.S. economy remain sound.

BOARD OF DIRECTORS

The thoughtful insights provided by our Board of Directors allowed us to accomplish a great deal in 2001, and we are truly grateful for their valuable contributions. I am pleased to report that Charisse R. Lillie, partner at Ballard Spahr Andrews & Ingersoll, has been re-appointed chairman of the Board of Directors, and Glenn A. Schaeffer, president of the Pennsylvania Building and Construction Trades Council, has been re-appointed deputy chairman.

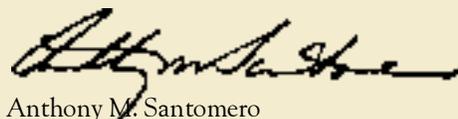
We offer our sincere thanks to those who completed their terms of service on our Board of Directors: Rufus Fulton, chairman, president, and CEO of Fulton Financial Corporation, and Howard Cosgrove, chairman and CEO of Conectiv. Mr. Fulton has been appointed to represent the Third District on the Federal Advisory Council during 2002.

We look forward to the insight and guidance of our newest Board members: Walter E. Daller, Jr., chairman, president, and CEO of Harleysville National Corporation, and P. Coleman Townsend, Jr., chairman and CEO of Townsends, Inc.

SOME CLOSING THOUGHTS

Philadelphia's role in the monetary policy decision-making process became more pronounced in 2002, as our Bank now votes on the Federal Open Market Committee (FOMC). The FOMC consists of 12 Federal Reserve Bank presidents and the seven members of the Board of Governors and sets the course for monetary policy. While all Fed presidents attend and contribute to the discussions, only five vote. This is done on a rotating schedule of one-year terms.

Last year was a testament to the Philadelphia Fed's strength and dedication to progress. Going forward, we continue to expand our efforts to provide the Third District community with the most up-to-date economic information and research. As a responsible steward of the District's economic health, we maintain our focus on helping our region to grow and prosper. Now, we move forward — confident that our region's economy, like our nation's, is enormously resilient.



Anthony M. Santomero
President

April 2002

3 MAIN ROLES OF THE FEDERAL RESERVE

CONDUCTING MONETARY POLICY

- Is the role most visible to the general public
- Refers to the Fed controlling money supply, regulating economy, and controlling inflation
- Set with consideration for current national economic conditions; not determined by fixed ideology
- Requires constant vigilance so economy flourishes and growth is sustained

SUPERVISING AND REGULATING BANKING OPERATIONS

- Promotes the safety and soundness of District financial institutions
- Examines and supervises financial institutions in our geographic District
- Coordinates across Districts to also oversee all subsidiaries and parent holding companies
- Provides liquidity through discount window operations

MAINTAINING AN EFFECTIVE PAYMENTS SYSTEM

- Effective operation of U.S. payments system essential to a healthy economy
- Largest component of Fed operations
- Central to people's ability to make payments quickly and easily
- Philadelphia is largest check processing site in System, with an average of 5 million checks a night