

President's Message

The theme for our 2004 annual report is “Sharing Our Knowledge.” Knowledge is integral to everything we do as individuals and as a society. Each of us accumulates knowledge, and we use and share it as part of every purposeful activity in which we engage. Our organizations and institutions do likewise.

As the nation's central bank, the Federal Reserve provides a financial environment that fosters sustained economic growth and a financial system that is reliable and accessible to all. In pursuit of these objectives, we often share our knowledge, and we do so enthusiastically, because the more knowledgeable we make our constituencies – be they consumers, bankers, educators, the public at large, or our own employees – the closer we can come to achieving our goals.

In this opening letter, I will give you a quick overview of the ways in which the Federal Reserve Bank of Philadelphia endeavors to share its knowledge and the rationale behind those efforts. The essays that follow will convey to you the texture and substance of our programs. Along the way you will meet some of the many people at the Bank involved in their development and delivery. I hope you will find these efforts and the impact they are having as exciting as I do.

As an economist and a former professor, I am doubly aware of the value of economic education.

When people know how to assess economic costs and benefits, they make better decisions about how much to spend, where to invest, and what career to pursue. When voters understand the fundamental workings of the economy, they support better public policy choices, both in their local community and for the nation. In short, well-informed economic decisions and well-understood economic policies are the building blocks for success in a market economy and a democratic society.

As president of this Bank, I see every day how sharing knowledge helps the Federal Reserve achieve its mandated mission – as monetary authority, as bank regulator, and as payments system provider.

For instance, by helping people understand the cross-currents affecting the economy and articulating the value of a stable price environment, we at the Fed

strengthen the public mandate for a monetary policy that promotes full employment and sustainable economic growth. Moreover, by maintaining an open dialogue with academia, civic leaders, and the business community, we advance our collective knowledge about the economy, and hopefully, we make better policy decisions ourselves.

As a regulator, the Federal Reserve is responsible for promoting safe and sound practices in the banking industry. Over time, industry conditions change, new laws are enacted, and new regulations are written.

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By keeping the bankers in our District up-to-date on these developments, we help them adapt more readily to changing standards. The Fed also oversees the industry's compliance with many consumer protection laws. Here we aim to educate not only the financial institutions but the consumers themselves about their protections under the law. Sharing our knowledge with both sides and building a common understanding are surely the best ways to ensure that the law achieves its intended purpose.

The Federal Reserve is also responsible for maintaining a reliable and efficient payments system. This is an area where new information technology is driving tremendous change. Consumers and businesses are rapidly relinquishing paper transactions – handling cash or writing checks – in favor of electronic ones, swiping a card or logging on to a computer. The challenge for the Fed is to preserve the reliability we have all come to expect from paper-based payments without diminishing the convenience that the new electronic

forms of payment offer. Again, sharing our knowledge is an important part of meeting the challenge. The Fed aims to keep both financial institutions and their customers up-to-date on developments in electronic payments, including current standards for processing transactions, disclosure of fees, protection from fraud, and recourse in the event of an error. The Fed also keeps legislators up-to-date on payments technology, so that they can establish standards that provide both reasonable safeguards and ample opportunity to innovate.

So sharing our knowledge helps us achieve our mission in all its dimensions. But how do we actually go about sharing this knowledge?

Reaching Our Constituencies

When it comes to providing economic education to the individual, we have developed a three-part approach. First, we support programs that help young people learn more about economics at school. Second, we support programs that help adults get the back-

The wisdom and leadership of our Board of Directors are of inestimable value in guiding the Bank through changing times.



Federal Reserve Bank of Philadelphia President Anthony M. Santomero (center right) with (left to right) Doris Damm, Deputy Chairman, Board of Directors; Ron Naples, Chairman, Board of Directors; and Federal Reserve Bank of Philadelphia First Vice President William H. Stone, Jr.

ground they need to handle their immediate economic and financial decisions. Third, we offer programs that help the public at large understand the ever-changing structure of the U.S. economy.

Supporting economic education for school-age children is at the core of our efforts because we recognize that broad-based economic education now will translate into a society of more financially literate adults in the future. Unfortunately, the basic concepts of economics and finance often receive only cursory treatment in many schools. Sometimes, they are excluded altogether. As a consequence, graduates enter adulthood ill-equipped to make good life choices about their careers or their personal finances. This situation has led the Bank to focus on programs that integrate economics and finance more fully into school curricula at all levels. We also provide teachers with presentations and seminars to enhance their own background in these subjects and with classroom materials and training on their use. By working with schools and teachers, the Philadelphia Fed can leverage its knowledge resources and have a substantial impact.

We are not alone in this effort. All across the country, the Federal Reserve System is playing a valuable role in educating young people about the financial system and its role in a market economy. Each Federal Reserve Bank has its own economic education specialists and tailors its programs to the needs and resources of the District it serves. With our Bank situated on Independence Mall in the heart of historic Philadelphia, we offer the visiting public “Money in Motion,” a history-based look at central banking in the U.S. By partnering with area educators, we are now leveraging the exhibit as an educational resource for area students.

The Bank also has been active in bringing eco-

omic education and financial literacy to adults across the District. Financial literacy is a person’s best defense against financial fraud and abuse, and so we seek to offer people financial education before they fall victim to unscrupulous business practices. Like any good inoculation program, financial education is most effective if it is targeted at the most vulnerable among us. In this case, the most vulnerable are older people, people in low- and moderate-income communities, and those with a poor credit history.

We provide both literature to consumers themselves and curricula to those who counsel and instruct them.

As a regulator, the Fed specifies the information that financial institutions must provide in the disclosure forms they give their customers. But these disclosures are useful only if consumers

can read and understand them. So we think supporting financial literacy is an essential element of our approach to effective regulation.

But our posture is not a purely defensive one, geared to protect the consumer from harm. Over the long term, we hope to help all consumers master the basics of money management, empowering them to take control of their financial futures. An example of our success in this endeavor is our faith-based financial education initiatives, which have been quite effective in making inroads in communities around our District.

Yet our young and at-risk populations are not the only ones that need education. In today’s rapidly changing world, education is becoming a life-long process for virtually everyone. Recognizing that the Bank has a part to play in that process, we have expanded our efforts to keep the public up-to-date on changes in the financial landscape. We are continually enhancing our “Money in Motion” exhibit. For instance, in 2004 the new \$50 bill made its debut. We held several

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events to educate the public about currency authenticity and to point out the security features of the new bill. In addition, we produced brochures on consumer credit topics such as identity theft and credit card fraud.

Networking with the Research Community

Our research economists maintain close ties with a number of the major colleges and universities in our area. Many of our economists are engaged in the national and international academic scene, as well. And we often host prominent scholars for a semester or more of research and interaction here in the Bank. This rich network of knowledge-sharing helps advance the frontiers of economic science.

Engaging the Banking Community

The Philadelphia Fed also made a significant investment in educating the banking community during 2004. In October, the payment system took an important step forward with the enactment of the Check Clearing for the 21st Century Act. Check 21, as it is known, establishes the legal structure necessary to enable the transition from paper to electronic check processing. To take full advantage of this new opportunity, the Federal Reserve launched an aggressive program to move all retail payments to electronics. To engage the banking community in this effort, the Bank actively shared its knowledge about the implications of Check 21 with District banking leaders and kept them informed about the evolution of Federal Reserve payments processing throughout 2004.

Aside from developments in payments, our bank supervision and regulation staff offered a number

of programs to brief Third District bankers on recent changes in the law and to discuss emerging trends in the financial services industry.

Building Our Knowledge

We are pleased to share our knowledge and contribute to the continual learning process of our constituencies. But we too must be continual learners if we are to pursue our mission effectively. Recognizing this,

our Bank has been quite active in developing educational programs, not only for our own staff members but for our colleagues across the entire Federal Reserve System. Our Professional Education Program (PEP) and its partner, ePEP, combine traditional classroom and technology-based instruction to provide a high quality “blended learning” experience for all business lines throughout the System. Through this program, we help the Federal Reserve build the knowledge it needs to meet the challenges of a

changing world.

I am proud of all of the contributions to education and knowledge sharing that the Philadelphia Fed makes. I believe they make a difference in our District’s communities, in the financial services industry, and across the Fed System. As I said at the outset, I believe they serve us well in the pursuit of our mandated mission. As you read this report, I hope you come to share my perspective.

Board of Directors

In the context of this year’s report, it is particularly fitting that we recognize the contribution of our Board of Directors, who share their knowledge with us so generously. Their wisdom and leadership are of

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inestimable value in guiding the Bank through these changing times.

I am pleased to report that Ronald J. Naples, chairman and CEO of Quaker Chemical Corporation, has been reappointed chairman of the Board of Directors, and Doris M. Damm, president and CEO of ACCU Staffing Services, has been reappointed deputy chairman of the Board of Directors for 2005. In addition, P. Coleman Townsend, chairman and CEO of Townsends, Inc., has been re-elected to a second three-year term.

We greatly look forward to the counsel and guidance of our newest Board member, Wayne R. Weidner, chairman of National Penn Bank. At the same time, we offer our sincere thanks to Walter E. Daller, Jr., chairman, president, and CEO of Harleysville National Corporation, who completed his term of service on our Board of Directors. His insights will be missed.

I would also like to acknowledge the contribution of Rufus A. Fulton, Jr., chairman and CEO of Fulton Financial Corporation. We had the pleasure of his service for three years on our Board (1997-2000), and he represented the District admirably on the Federal Advisory Council (FAC) from 2001 to 2004. In his stead, we are also pleased to announce that Bruce L. Hammonds, president and CEO of MBNA Corporation, has been appointed to represent the Third District on the FAC. On behalf of all of us here at the Philadelphia Fed, I thank our Board members for their thoughtful insights and commitment to public service.

A Closing Thought

Before closing, I will mention that Philadelphia's role in the monetary policy decision-making process is now somewhat more pronounced because 2005 is a voting year for Philadelphia on the Federal Open Market Committee (FOMC). As many of you know, 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 on the final decision. The voting schedule is dictated by the Federal Reserve Act and is done on a rotating schedule of one-year terms. So expect the Philadelphia Reserve Bank to be even more closely watched in the year ahead.

At times like this, I especially appreciate the strong support I receive from the Third District business community, our Board of Directors, our Research Department, and the Bank's advisory councils, as well as from all of the employees who keep us in touch with the Third District.



Anthony M. Santomero
President
April 2005