

PHILADELPHIA MAKES THE FINAL FOUR

Philadelphia emerged as a key player when it was chosen as one of four Federal Reserve Banks that will continue to provide full-service check processing for the country's commercial banks until at least mid-2011. Philadelphia's long-term leadership in processing paper checks — and, more recently, electronic images — gave it a clear advantage as the Federal Reserve System was evaluating Reserve Banks that met the criteria to continue full-service operations.

"Our high performance paid off in terms of customer service, efficiency, products, and innovation," said Arun Jain, vice president of the Philadelphia Fed's Retail Payments Department. The Cleveland, Atlanta, and Dallas Reserve Banks were also selected as full-service check locations in June 2007 based on their performance ratings, market conditions, and location.

The Fed's latest check consolidation announcement is part of a multi-year strategy to manage check processing capacity with declining check volumes. Consumers and businesses are writing fewer paper checks and using credit and debit cards more, circumstances that have led the Fed to reduce its check processing sites from 45 to 19 since 2003. This transition to electronic collection of paper checks allows paper checks to be collected more efficiently with fewer geographically dispersed offices. The Fed's underlying goal is to meet its statutory requirements for long-term cost recovery while still providing the best possible check collection service for the nation.

Each of the four full-service regional sites will be somewhat similar in size and will have the flexibility to accommodate additional processing to absorb closing offices' volume without increasing staff or adding equipment. These four offices will process paper checks and electronic images, print substitute checks,

and provide reconciliation and settlement services. Other Federal Reserve check sites that have closed or will close their full-scale operations will most likely retain limited service capacities depending on market demand.

Our Bank's primary strengths in meeting this challenge will be the experience, dedication, and in-

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novativeness of its staff. "Philadelphia has long been recognized as a leader, and we are doing everything we can to continue to be a top service provider. We are striving to achieve the ultimate status as the sole check site when that day comes," Jain said.

But for now, Philadelphia will assume check processing for sites in New York, Connecticut, and Maryland in consolidations planned through 2009. The transition to a regional site began in 2006 when the Bank began processing checks for FRB New York's main operations center and continued in early 2008 with the consolidation of its Utica, N.Y., office. "We are incorporating the lessons learned from the consolidation of the New York Federal Reserve's East Rutherford Operations Center (EROC) in 2006. EROC was a huge undertaking that resulted in a 60 percent increase in check volumes," Jain said. But unlike with EROC, the workload for Utica's consolidation will add roughly 10 percent more volume and will not require additional staff or equipment.

Later this year, most of Philadelphia's check adjustments function will move to one of the three other regional adjustment sites. As a result, staffing in

the adjustments area will be slightly reduced, but the Bank will handle the reductions through attrition and employee reassignments. Jain explained, "We took steps during hiring for EROC to manage our staff so there would be as few job reassignments as possible."

The Philadelphia Fed has kept its employees and its customers aware of how changes in the Fed's operations will affect them. "We have been aggressively promoting electronic payments to consumers and banks to foster a more efficient system," Jain said. The Fed was a supporter of a law commonly known as Check 21 that encourages the use of electronically transmitted check images to increase efficiency. The law, which went into effect in 2004, allowed banks to use substitute checks created from original paper checks as the legal equivalent, with the ultimate objective of achieving end-to-end electronification of the paper check.

Financial institutions are moving toward depositing transactions electronically because it's fast and efficient and can reduce certain errors. The Fed reports that over 50 percent of check deposits are sent electronically. However, only about 30 percent of check presentments are made electronically. The Fed prints substitute paper checks for institutions that do not yet receive payments electronically.

There is no telling when the balance of banks

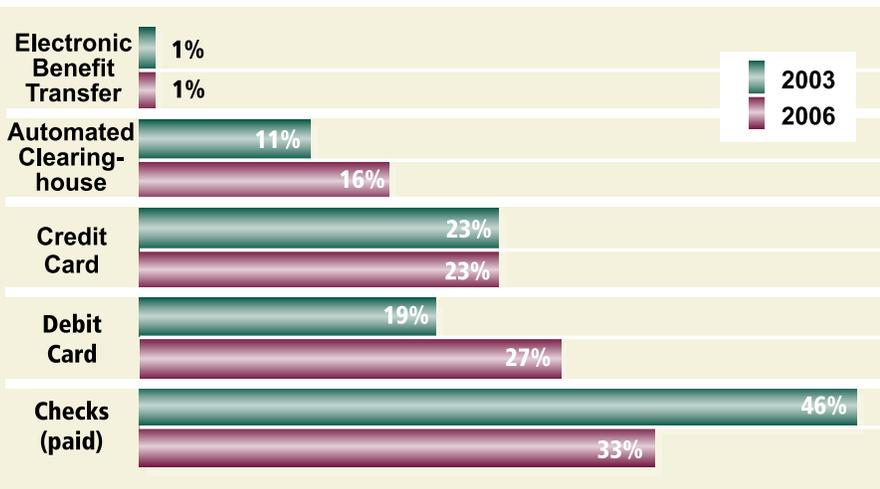


will adopt electronic collection methods, but the Fed is seeing an acceleration in the adoption of electronic receipt. Research shows that improved costs and convenience are driving businesses and consumers to electronic payments. In fact, a 2007 study by the Federal Reserve showed that two-thirds of all noncash payments in the United States are made electronically and that these payments grew 12.4 percent per year from 2003 to 2006. Around 62.7 billion electronic payments were made, totaling \$34.1 trillion in value. "Checks are continuing to decline at an even faster pace than we saw two or three years ago," Jain said. However, even though electronic payments comprise

more than two-thirds of all noncash payments by number, they represent less than half by value. Checks still have considerable volume. In 2006, 30.6 billion checks were paid, with a value of \$41.7 trillion.

The Federal Reserve remains committed to providing high-quality check processing and aligning its services with market demands. The Fed will continue to research trends and review its own check processing services each year to promote the long-term integrity, efficiency, and accessibility of our nation's evolving payments system.

DISTRIBUTION OF THE NUMBER OF NONCASH PAYMENTS



Source: The 2007 Federal Reserve Payments Study: Noncash Payment Trends in the United States: 2003-2006