

by *William H. Stone, Jr., First Vice President*

Restructuring Checks

As most of you know, paper checks continue to give way to electronic payment methods. A recent Federal Reserve study shows that two-thirds of all payments in the United States are made electronically. This evolution has significant implications for the Fed's check processing infrastructure. As consumers and businesses continue the steady shift from paper to electronics, the Federal Reserve has responded by consolidating its check processing businesses.

This restructuring is part of the evolutionary process as check volumes decline. It allows us to fulfill our traditional role of payments processor while maintaining efficiency in this new environment. Having fewer Reserve Bank locations in the check business continues to bring about substantial cost savings.

The Philadelphia Fed is one of four regional check processing sites that will provide a full range of check processing services through at least mid-2011. Philadelphia, along with the Cleveland, Atlanta, and Dallas Reserve Banks, was selected based on perfor-

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mance, market conditions, and geographic location.

We have a long history of strong performance in payments processing. While the restructuring of our check operations will continue to present challenges, we are confident that our Bank is up to the task. Our Retail Payments staff is dedicated, experienced, and innovative, and we will continue to support our customers' needs. As always, we are fully committed to the Federal Reserve's mission to promote the efficiency and integrity of our nation's payments system.

Changing Cash Services

Like our checks business, our cash business has also been undergoing an evolution. In response to

a changing industry environment, Federal Reserve cash processing services have become more efficient and effective than ever before.

Our new currency recirculation policy represents a significant shift in the dynamic between depository institutions and the Fed and is expected to have a significant impact on operating policies at depository institutions that handle large volumes of currency. These institutions are moving away from traditional currency activity toward greater reliance on Reserve Bank cash processing. The primary reason for this behavioral change was depository institutions' desire to reduce the dollar value of currency on their books, since cash is a nonearning asset and many banks hold more cash than they need to meet reserve requirements.

Under the new currency recirculation policy, the Federal Reserve expects depository institutions to recirculate to their customers fit currency deposited with them and to deposit only excess or unfit currency with Federal Reserve Banks. To promote this policy, we have implemented a custodial inventory program, which will permit depository institutions to transfer a percentage of the \$10 and \$20 notes in their vaults to the Fed's books. In addition, the Federal Reserve's Cash Services began billing for additional handling and processing of currency deposited and withdrawn from the Federal Reserve in the same week. This program will allow the institutions to reduce the size and frequency of their deposits of currency and orders from the Reserve Banks. For our part, we will continue to meet the needs of our cash customers while avoiding the unnecessary handling of currency.

Working with the Treasury

Because of Philadelphia's already successful and long-standing working relationship with the U.S. Treasury as well as our well-known expertise in managing collateral, the Philadelphia Fed has been chosen to head the Treasury's collateral management and monitoring business. This effort is part of the Treasury's Collections and Cash Management Modernization (CCMM) project — a key element of structural change in the way the Treasury does business. The Bank will develop a new application to handle collateral monitoring for new investment options and existing Treasury collateral programs.

For many years, our talented and experienced staff has supported the delivery of collateral, credit risk management, and monitoring activities, and we're now excited for the opportunity to be part of this effort.

In addition to leading the collateral management and monitoring business for the Treasury, the Bank will be responsible for developing a new collateral application that will provide external access to financial institutions, agencies, and the Treasury and will support new Treasury investment options. Philadelphia will also play an instrumental role in analyzing guidelines for collateral eligibility and valuation methods.



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Enhancing Security

The strength of the financial system depends on the effectiveness of the Federal Reserve System. Accordingly, the Philadelphia Fed works hard to create sound contingency plans. Our safeguards ensure there will be no disruptions to America's payments system. Over the past several years, our nation has been required to react to a number of threats, including terrorism, natural disasters, and financial crises. This has led us to review our response procedures as well as to increase our information security to prevent the likelihood of a cyber attack.

As part of our preparedness, we started thinking harder about security — an issue that has always been of the utmost importance to the Fed. As the central bank, the Fed must make certain that people feel secure. This includes our customers' security about business continuity as well as our employees' assurance of physical security at work. Our customers and the public at large must be confident in the Fed's ability to supply liquidity and maintain a sound financial system. Our employees' safety ensures they will be able to perform their jobs, which, in many of our busi-

ness units, are critical to a smoothly functioning payments system.

In our ongoing efforts to enhance our Bank's physical security, we have increased training and resources for our federal law enforcement officers. We are also in the process of building an off-site screening facility on a 31,500-square-foot parcel of land located directly across from the Bank's 7th Street entrance. Equipped with state-of-the-art technology, this facility will allow us to identify and mitigate potential threats a safe distance from the main Bank building.

Strength Through Change

The changing environment within the financial services industry challenges us to be continually innovative, to strengthen our processes, and to prove our technical and project management skills.

In 2008 and beyond, the Philadelphia Fed will continue to develop new and better ways to improve its work and build its capabilities. Through change, we've continued to show strong performance and strong customer service. We have proven we can adapt to change and grow stronger in the process.