TREASURY TAPS PHILADELPHIA'S EXPERTISE AGAIN

In 2006, the Treasury's Financial Management Service (FMS) office announced that it was embarking on a comprehensive, multi-year effort to streamline, modernize, and improve the processes and systems supporting Treasury's collections and cash management programs. This new project is the Collections and Cash Management Modernization (CCMM) initiative.

In June 2007, Treasury Secretary Henry M. Paulson, Jr., stated that "to maintain our capital markets' leadership, we need a modern regulatory structure complemented by market leaders embracing best practices. The steps we are announcing today will help to strengthen our global competitiveness." One of those steps includes the modernization of Treasury's cash and debt management. The department will strengthen the U.S. government's cash and debt management systems through a broad series of public initiatives, further improving the efficiency, integrity, transparency, and competitiveness of the U.S. Treasury market.

Also in June 2007, the Treasury chose the Federal Reserve Bank of Philadelphia to lead its collateral management and monitoring business line. Being chosen to lead this project was not a matter of chance. The Philadelphia Fed's First Vice President, Bill Stone, said, "Our Bank was selected to lead the Treasury's collateral management and monitoring business because of the talented and experienced staff in Philadelphia, who, for many years, have supported the delivery of collateral, credit risk management, and monitoring activities."

Pictured left to right (seated): Marie Tkaczyk, Assistant Vice President, and John Ackley, Assistant Vice President; (standing): Bob Mucerino, Collateral Management National Support Service Manager; Wendy Fasbinder, Project Manager; and Chris DeYoung, Group Manager, Systems Development.

Background

In 2003, the Subcommittee on Credit Risk Management asked the Federal Reserve Bank of Philadelphia to help streamline and modernize the Reserve Banks' collateral management system. Completed in 2006, that project entailed converting a complex centralized system to a web-based portal platform that paved the way for portal technology to be implemented throughout the Federal Reserve System. That effort resulted in the new Collateral Management System (CMS), which administers the collateral that financial institutions post when they borrow from the Fed and values collateral held on behalf of the Treasury.

The Bank's management took a significant step on behalf of the credit risk management community when it began to develop the CMS using portal technology, an application that had never before been used by the Federal

Reserve at the national level. In July 2006, the CMS team successfully completed the project that upgraded and modernized the system. The project team's design meets the needs not only of the Fed but also of certain collateral programs for the U.S. Treasury.

The CMS staff, in partnership with an experienced development staff, maintains the software application that allows Federal Reserve Banks to calculate accurate collateral values for assets financial institutions pledge as collateral when they borrow from the Federal Reserve and assets pledged for Treasury collateral programs. Just as those who get loans for a house may put up collateral as security for the money they borrow, banks must also supply collateral for money borrowed from the Federal Reserve Banks. Collateral valuation methodologies are based, in part, on current market prices for these assets and a complex set of algorithms using characteristics of securities such as interest rates, time to maturity, duration, and asset quality. Since asset values can also change depending on area conditions, CMS also allows Reserve Banks to adjust values based on geographic conditions. The Federal Reserve System holds collateral with a current value of $1.34 trillion.

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The New Business

This successful completion of the CMS project, combined with the Bank's well-known expertise in managing collateral, resulted in the Philadelphia Fed's expanded responsibility as the leader of the Treasury's collateral management and monitoring business, which is part of the CCMM initiative. In a letter to First Vice President Bill Stone announcing the decision, then FMS Commissioner Kenneth Papaj said that after evaluating a number of other Reserve Banks, "we felt that the Philadelphia Reserve Bank was the best, most highly qualified candidate."

The Philadelphia Fed will be modernizing the Treasury's collateral management and monitoring business line. The Bank will be responsible for developing a new collateral application that will provide external access to financial institutions, agencies, and the Treasury and support new Treasury investment options. Furthermore, Philadelphia will play an integral role in analyzing guidelines for collateral eligibility and valuation methods.

Although this particular aspect of the Treasury's program is new to Philadelphia, the business line is really an extension of work that the Bank has been doing for quite some time, dating back to the 1980s. At that time, the Philadelphia Fed managed the largest customer safekeeping service in the Federal Reserve System. In the 1990s, the Bank developed a PC-based local area network application to update older mainframe technology. And, of course, for the new project, the Bank can also call on its experience in developing the CMS.

The collateral management and monitoring project is still in the early stages. "Right now," says Assistant Vice President John Ackley, "we're in fact-gathering mode in partnership with FMS staff. We need to identify current processes, what the Treasury, federal agencies, and financial institutions want to enhance, and what current and new investment options the Treasury is planning. Then we'll define our project plan accordingly. We're also studying the Treasury's project management and development methodologies."

To support the new business line, the Bank will also add an operations group to handle day-to-day collateral management and monitoring functions and will establish a Central Business Administration Function (CBAF). The CBAF will direct program changes, test and implement enhancements, oversee and test software and hardware upgrades, and monitor system performance.