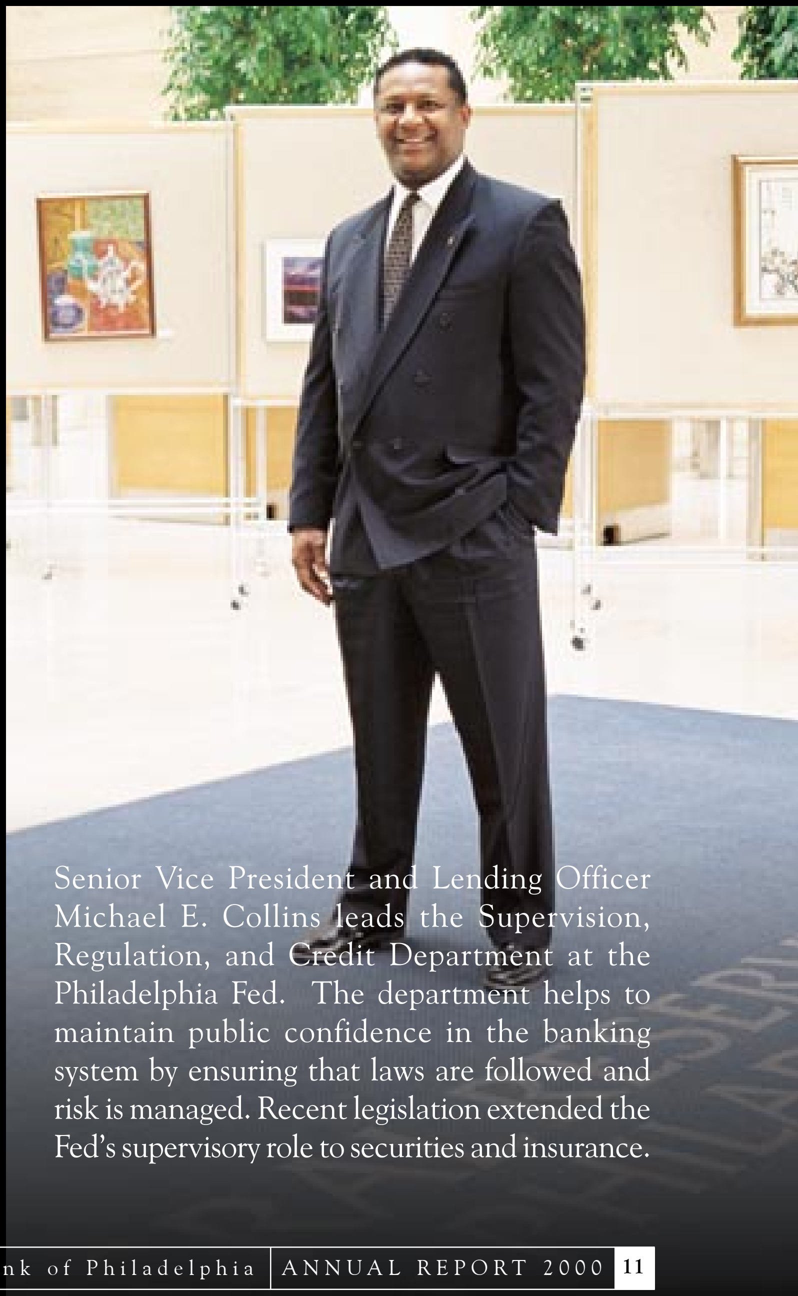
Supervision, Regulation, and Credit

Managing Risk

Worldwide banking trends are evident in the Third Federal Reserve District, which includes central and eastern Pennsylvania, southern New Jersey, and all of Delaware. Here, as they have across the country, financial services have converged as regulatory barriers have dissolved. Depository institutions have consolidated and have expanded their functions by merging with providers of uninsured financial products. In managing personal finances, individuals have more freedom, more information, more options, more decisions, and, often, more confusion than ever before.

The Federal Reserve is charged with maintaining a sound and responsive banking system, working in cooperation with other federal and state banking agencies to ensure that laws are followed, risk is managed effectively, and responsive relationships are maintained with communities and other constituencies. As the financial services landscape has changed, however, the Fed's approach to supervision has changed too, most significantly in the past year.

The Financial Modernization Act of 1999 enabled bank holding companies to affiliate with securities and insurance firms and also established a new supervisory structure. Each financial function is directly supervised: banking



Senior Vice President and Lending Officer Michael E. Collins leads the Supervision, Regulation, and Credit Department at the Philadelphia Fed. The department helps to maintain public confidence in the banking system by ensuring that laws are followed and risk is managed. Recent legislation extended the Fed's supervisory role to securities and insurance.

by the Federal Reserve and other federal and state authorities, securities by the Securities and Exchange Commission, and insurance by state-level commissioners. In addition to serving as a primary supervisor for banking, the Federal Reserve is required, under the new framework, to coordinate activities with the appropriate supervisors of financial holding companies' banking, securities, and insurance subsidiaries.

The Philadelphia Fed's supervisory and regulatory functions reside in the Supervision, Regulation, and Credit Department (SRC). *Supervision* entails the continuous oversight and examination of banking organizations to assess their condition and compliance with pertinent laws. *Regulation* involves formulating guidelines for bank structure and conduct. *Credit* refers to the department's administration of the credit discount window. The Fed provides short-term liquidity to depository institutions in times of unexpected demand for cash reserves, thus serving as a buffer against unanticipated fluctuation. In addition, when an institution experiences difficulty, the Fed is the lender of last resort.

The Federal Reserve directly supervises bank and financial holding companies, state-chartered banks that are Fed members, and Edge Act corporations, which are formed by domestic banks to engage in international banking activities in the United States and to make overseas investments in foreign organizations. With regard to other banking institutions, the Fed shares supervisory duties with the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and state and foreign authorities.

As a bank supervisor, the Fed approves the formation of new institutions; collects financial statistics on banks' condition; examines bank holding companies, banks, and many of their nonbanking subsidiaries; and takes remedial action when necessary. In the Third District, the Philadelphia Fed supervises 150 banking organizations headquartered in the District, including 20 financial holding companies. Because Delaware has a high concentration of credit card banks, and many major banks have overseas operations in the District, the Philadelphia Fed's supervision team has become particularly skilled in these areas, expertise that is shared with other examination teams across the Federal Reserve System.

As overall supervisor of financial services, the Fed will take the same approach it does in its primary regulation activities: it will emphasize fairness, promptness, and consistency, to promote confidence among institutions and the public. It recognizes risk as an inherent part of financial dealings and evaluates institutions' condition by assessing their ability to manage risk. Stress-testing balance sheets is one way the Fed makes this assessment. Such testing is particularly important with the integration of insured and uninsured activities within institutions and with the increasingly dense technological and international web in which financial transactions occur. Given the evolution of the financial services industry into large and small entities, the Fed recognizes the need to tailor examination activities to the size and complexity of an institution. The Fed will continue to be proactive as a supervisor by continuously enhancing information gathering, analysis, coordination, and communication.

Sometimes the best way to ensure that financial services are accessible to all segments of the community is to simply bring together the people involved. The Fed's Community and Consumer Affairs Department serves as a regular contact point for financial institutions, businesses, and community groups. The Bank often sponsors meetings on emerging financial issues, development opportunities, and needs for concerned groups. In 2000, topics included credit options for minority entrepreneurs and strategies to combat predatory lending.