

OUR MISSION *and* RESPONSIBILITIES

First Vice President Bill Stone shares his perspective on how three major projects allowed the Philadelphia Fed to capitalize on its areas of strength and pursue leadership opportunities that benefit not only the financial system but the Bank, the Federal Reserve System, and the Treasury.

Since the creation of the Federal Reserve in 1913, its mission and responsibilities have evolved. The Fed has learned that its actions have significant effects on the financial system and overall economy.

While all areas of the Federal Reserve's mission — monetary policy, bank supervision and regulation, and payments — have changed dramatically since 1913, the biggest changes in recent years have been in the payments system. Payments have been part of the Fed's core activities since the beginning, and they are the largest component of Federal Reserve operations. Moreover, this is an area in which the Fed faces both intense competitive pressure from the marketplace and the forces of technological change that have been a hallmark of the past several decades.

That is why three major System projects implemented by the Philadelphia Fed in 2006 are of special importance. Full details on each of these are presented later in this report.



William H. Stone, Jr.
First Vice President

EROC Consolidation

On August 18, 2006, the Philadelphia Fed — home to one of the Federal Reserve's largest check processing centers — absorbed New York's East Rutherford Operations Center (EROC) in the largest System

consolidation yet in the Fed's check restructuring efforts. In many ways, this consolidation was a significant undertaking for the System and the Bank.

"This is part of the evolutionary process as check volumes decline," says Stone. He goes on to explain that changes in the payments system, driven by the industry's ongoing shift to electronic forms of payment, have necessitated consolidations among the Fed's check processing operations. In each of the past several years, the Federal Reserve's Retail Payments

to move EROC's operations here. In addition, Philadelphia's geographic proximity to New York made it the logical candidate for consolidation with EROC. EROC staffers were instrumental in helping the Bank prepare for and implement the consolidation. Staff from other Reserve Banks and the Federal Reserve's Retail Payments Office also played important roles in the consolidation.

Stone attributes much of the decision to the Bank's painstaking preparations. "We had positioned our-

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Office has made recommendations for restructuring the Fed's check processing infrastructure. "This restructuring allows us to fulfill our traditional role of payments processor while at the same time maintaining efficiency in this new environment. These consolidations bring about substantial cost savings and are consistent with the System's direction for fewer Reserve Bank locations involved in the check business," explains Stone.

For the consolidation to be successful, it was imperative that the New York and Philadelphia Fed check processing sites be able to work together to provide a nearly seamless transition in service to customers. Philadelphia's reputation as a high-quality and efficient operation played a key role in the decision

to be able to take on System consolidations. When the time came, we were ready for the opportunity. Given the complexity of this particular consolidation and that it was the largest to date, we are particularly proud it was executed so smoothly. The EROC consolidation has become the System benchmark for the successful implementation of a large-scale consolidation," Stone reports.

Stone sums up the success of the project in two words: "dedicated staff." He continues, "The most important component of this restructuring was, without doubt, our Retail Payments staff. Our staff rose to the challenge, and I was proud to see their dedication and teamwork. They understood and focused on the importance of this consolidation as a

determinant of our future success. Individuals across the Bank came together to reach our goals.”

In addition to good planning and hard work, the project’s success relied heavily on Retail Payments’ ability to meet customers’ needs throughout the transition. “This required early communication with customers whose service would be affected and a thorough understanding and ongoing analysis of customer service issues throughout the process,” says Stone.

Before absorbing EROC’s check volume, Philadelphia had been processing nearly 3.5 million checks per day. Following the merger, daily volumes averaged over 5 million. The Philadelphia Fed has long been a leader in the System with a premier check operation, but this new responsibility meant additional employees, equipment, and space renovations to accommodate the increased workload. These changes required support and cooperation from departments across the organization. Building staff worked hard to prepare and reconfigure the physical space. Human Resources recruited and trained new employees and guided them through the hiring process. Protection officers did background checks and supplied employee badges. Among the new staff were some transfers from the EROC facility who knew the business and customers and whose efforts were invaluable in helping to smooth the transition. Additional EROC staff worked in Philadelphia through the first several weeks of the consolidation.

Collateral Management System

The Collateral Management System (CMS) software redevelopment project was another bright spot in a year of operational success stories. The Philadelphia Fed was asked to re-engineer the CMS on behalf of the

Federal Reserve System’s Subcommittee on Credit, Reserves, and Risk Management (SCRRM). This System initiative, which allows straight-through processing of collateral, successfully implements portal technology and includes an automated interface that addresses the needs of the Fed’s depository institutions.

The Philadelphia Fed was assigned this project not only because it ran the system being replaced by the CMS but also because Bank staff had the specialized skills best suited to the task. Stone elaborates, “We were able to bring an understanding of the business requirements for a collateral management system as well as expert knowledge of how the system operates. And importantly, we could bring together the technical expertise to build such a system.”

This initiative involved the conversion of the existing CMS to a System standard technology and allowed the Bank to use the Federal Reserve’s intranet as a way to deliver service. Essentially, the goal of the project was to convert the CMS from a client-server-based application to a web browser application. This provides more seamless user access, alleviates redundancy, and reduces costs.

Treasury Check Information System

In 2001, the U.S. Treasury asked the Philadelphia Fed to modernize and improve the outdated application used for its check processing and reconciliation system. This check processing and reconciliation system is essentially the Treasury’s checkbook — a vast system that tracks all government checks issued and paid and handles claims that arise when checks aren’t received or when a check was sent erroneously.

The Treasury sought out the Philadelphia Reserve

Bank to assist in developing sophisticated programming tools that would create a new and more efficient means to reconcile Treasury checks. The Bank was charged with this monumental task based on its strong relationship with the Treasury, its excellent track record in other Treasury joint initiatives, and its proven expertise in check processing. The Bank's

225 million check payments and 600,000 claims a year and stores data for up to at least seven years. That means TCIS will allow online retrieval of information on more than 1.5 billion check payments and 4 million check claims over a seven-year period.

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long working relationship with the Treasury helped simplify the overall development effort, which provided the Treasury with such benefits as improved automation and the elimination of paper-based operations.

Philadelphia produced a very strong proposal for taking existing technology, integrating it into a very critical area of Treasury operations, and then determining what software to develop to make it work in the Treasury's environment. Stone explains, "The final result was the successful creation of a product that addresses a critical business need and automates the reconciliation of the Treasury's checkbook."

The Bank worked closely with the Treasury's Financial Management Service to develop the final product: the Treasury Check Information System (TCIS). This fully web-enabled infrastructure records and reconciles the worldwide issuance and payment of U.S. Treasury checks. Currently, TCIS processes more than

225 million check payments and 600,000 claims a year and stores data for up to at least seven years. That means TCIS will allow online retrieval of information on more than 1.5 billion check payments and 4 million check claims over a seven-year period. TCIS ensures the highest levels of financial integ-

Changing Environment, Certain Future

The three System projects successfully completed by the Philadelphia Fed last year bring to light the changing operations environment within the Federal Reserve.

"Both CMS and TCIS may involve additional opportunities for us as the projects expand. Furthermore, the success of the EROC consolidation positions us well for further consolidations into 2008 and beyond." Stone concludes, "We are leveraging successes, strengthening our processes, and proving our project management skills. This is a testament to the credibility of our work and will allow us to build ever-stronger capabilities in the future."