

MESSAGE FROM MANAGEMENT

Striking a Balance



Sarah G. Green
First Vice President and
Chief Operating Officer

The federal government deficit is a complex topic that has received a tremendous amount of public discussion in the past year. Generally, the cost of operating government organizations adds to the size of the deficit. In contrast, the Federal Reserve System funded its own operations and provided net payments of approximately \$88.4 billion to the United States Treasury in 2012. The Fed's income derives largely from interest on securities held as assets on its balance sheet. Regardless of the amount of income earned, the System's officers and staff understand the importance of accomplishing our mission in the most effective *and* efficient manner so we can return the maximum amount of earnings to the Treasury each year.

As a regional Reserve Bank, the Richmond Fed's mission is to serve the public by fostering the stability, integrity, and efficiency of our nation's monetary, financial, and payments systems. We accomplish this mission by conducting monetary policy, by supervising and regulating financial institutions, and by providing payments services to financial institutions and serving as fiscal agent for the Treasury. Effective performance of these roles supports economic growth in the United States, and economic growth also helps reduce the deficit.

In 2012, our economists contributed research related to issues such as why the unemployment rate has not fallen as quickly as in some previous economic recoveries. This research helps us understand the extent to which persistently high unemployment reflects a mismatch between skills available in the labor force and skills needed by employers. This informs both monetary policy discussions and workforce development initiatives—efforts that are important to local, regional, and national growth.

Another area of policy focus is “Too Big to Fail.” The Bank's economists have estimated the so-called “financial safety net,” which is the extent to which there is implicit or explicit government willingness to intervene when an institution is near failure. These estimates suggest that the federal financial safety net covered 45 percent of the entire financial sector at the end of 1999. By 2011, it had grown to as much as 57 percent. A large safety net creates potential

incentives for financial institutions to take imprudent risks. The Bank has been actively involved in research and discussions about ways to resolve large institutions when they are near failure, along with implementing supervisory policies to mitigate the risk of failure. Stress tests of the largest financial institutions performed in 2012 show that they are now much better prepared than in 2007 to withstand a shock to the financial system. Also, each of the largest institutions has drafted a “living will,” or a strategy for winding down its operations in the event of financial failure without government assistance.

The Fifth District still has a number of community and regional financial institutions that are in weak condition, but during 2012, that number stabilized and began to improve. To ensure the most effective and efficient supervision of these institutions, we undertook a rigorous review of this function. As a result of that review, we are restructuring to add field staff and to improve the quality of the exams and the feedback to the community banks while maintaining level costs.

Reserve Banks are responsible for providing currency to financial institutions that in turn provide currency to consumers and businesses. The Richmond Fed operates the national Currency Technology Office, which develops the currency-processing equipment used at the 28 cash-processing sites throughout the Federal Reserve System. Over the past several years, this office rolled out an equipment upgrade that resulted in productivity gains of 20 percent, with estimated savings of \$26.8 million from 2009 through 2012. To keep ahead of counterfeiters, we worked with outside vendors to develop new sensors that enable our machines to process 40 notes per second while making approximately 50 decisions about the authenticity and fitness of each note.

As fiscal agent for the Treasury in 2012, the Richmond Fed transferred \$590 billion in grant payments, another \$123 trillion in intergovernmental payments, and more than \$75 billion in food stamp and related payments. We are constantly seeking quality improvements and cost savings in these operations.

On an average day, the Federal Reserve System processes more than \$4 trillion in Fedwire funds and securities, Automated Clearinghouse (e.g., direct deposit) payments, and check payments. The 12 Reserve Banks have worked together to build contingency processes that ensure the integrity and resiliency of these services. During Hurricane Sandy, for example, the Richmond Fed performed critical back-up services for Fedwire funds transfers and several other key payments functions. The Bank also processed \$92 million in emergency benefits on smart cards to individuals in New York and New Jersey who were affected by the storm.

Our quest to strike the best possible balance between providing high-quality and cost-effective services to financial institutions, the public, and the Treasury is embraced on a daily basis by our officers and staff. In 2012, we lived by our values to serve with integrity, to lead with courage, and to perform with excellence. Serving the public is both a responsibility and a privilege, and we thank you for trusting us to perform this service on your behalf.



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