

## 2002 Operational Highlights

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he mission of the Federal Reserve Bank of Cleveland is to enable the economy to achieve maximum sustainable growth by preserving the purchasing power of the dollar, promoting a strong financial system, and providing efficient and innovative payments solutions to financial institutions, the U.S. Treasury, and the public. This section summarizes the Bank's operational achievements in these three areas.

### ECONOMIC RESEARCH AND MONETARY POLICY

*In 2002, economic developments—including rising oil prices, low inflation, low interest rates, and growing geopolitical tensions—presented new challenges and opportunities in fostering stable prices and sustainable economic growth through monetary policy. In this environment of rapid change, anticipating and preparing for such change is one of the Bank's key responsibilities to the Fourth District and to the nation.*

The economic research staff are respected contributors to the discourse on topics that concern the Federal Reserve System and promote constructive discussion of those issues in the public domain. Research staff published articles and papers on monetary, economic, and banking topics in the Bank's annual report, in its *Economic Commentary* series, and in *Policy Discussion Papers* and working papers, as well as respected academic journals. In addition, the Bank hosted a conference (together with the *Journal of Money, Credit, and Banking*) on "Recent Developments in Monetary Economics."

One of the Federal Reserve Bank of Cleveland's key strategic initiatives has been the development of the Central Bank Institute. The Institute was established in 2001 to foster greater understanding of the monetary policy, supervisory, and payments aspects of central banking by promoting research and dialogue and by forging partnerships among central banks. In 2002, the Institute hosted three conferences on current monetary policy research and cosponsored two additional conferences with the Swiss National Bank and the Chicago Reserve Bank; altogether, 150 scholars took part in these programs. As part of its staff exchange program, the Institute hosted scholars from the central banks of Sweden, Austria, Azerbaijan, and the Kyrgyz Republic, while Cleveland Fed economists traveled to the Sveriges Riksbank, Bank of England, and Deutsche Bundesbank.

Public outreach is one of the Federal Reserve Bank of Cleveland's key objectives, and the public tour program and speakers bureau are the cornerstones of that program. In 2002, Fourth District staff delivered more than 55 speeches, reaching over 3,000 people. Although the Bank restricted its tour program during the first half of the year, more than 2,000 visitors toured the Cleveland Fed's historic building in 2002.

In the area of economic education, the Bank again sponsored the Fed Challenge competition, in which teams of high school students participate in mock Federal Open Market Committee deliberations. In addition, the Bank launched a new program, "Great Minds Think," which traveled to four cities across the Fourth District. The program—a partnership between the Cleveland Bank, the Ohio Department of Education, the Ohio Center for Economic Education, the Cleveland Public Schools, Jump\$tart, and the Foundation for Teaching Economics—highlighted the importance of critical-thinking skills for students and educators and centered on the concept of financial literacy. Nearly 300 students and 118 teachers (who teach 12,000 students annually) attended the workshops. Altogether, participation in District educational programs increased 130 percent in 2002.

The Cleveland Reserve Bank continued to develop plans for a Learning Center, which will foster a better understanding of the Bank's purposes and functions and provide an infrastructure for its educational activities. The centerpiece of the Learning Center will be a permanent Museum of Central Banking. In 2002, the Bank installed a temporary exhibit on "What Gives Money Value?" in the Cleveland Office, and it reviewed proposals to create a permanent exhibit that reflects the Bank's educational visions.

## SUPERVISION AND REGULATION

*Recent events and legislative changes have had a profound impact on the way bankers and supervisors view corporate governance and risk management in the financial services industry. Changes in the operations and credit quality of the banks and bank holding companies supervised by the Federal Reserve Bank of Cleveland continue to present new challenges and opportunities for the Bank's Supervision and Regulation function. Prominent among these forces are emerging technologies, industry consolidation, changes in the legal environment, and the ever-increasing need for information security.*

The Federal Reserve System's approach to supervision is founded on the principles of risk-focused supervision. This approach balances the need to continuously evaluate and assess the effectiveness of enterprisewide risk-management systems with the requirement to conduct adequate transaction testing. The Supervision and Regulation function applies these principles inwardly as well in developing risk-focused supervisors and examiners. Through its Risk Committee, supervision and regulation staff monitor emerging trends in the financial services and legal environment to direct resources to areas of highest risk. Throughout 2002, staff worked to improve their processes for assessing operations risk and corporate governance procedures at Fourth District institutions, as well as the effectiveness of its risk-based examination procedures.

The Bank regards communication, outreach programs, and training for bankers and the public as a fundamental part of its responsibility. In conjunction with the Ohio Division of Financial Institutions, the Bank developed a series of tailored programs to educate the board members and senior management of Fourth District financial institutions. The programs, which deal with topics such as corporate governance, auditing practices, risk management, liquidity, and current legislation, cover timely issues faced by the banking industry and foster more meaningful, open communications with bankers. Supervision and Regulation staff delivered 15 presentations throughout the Fourth District in 2002, and more are planned for 2003.

The Federal Reserve Bank of Cleveland is a strong advocate for fair lending, community economic development, and equal access to credit. To support these goals, the Bank's community affairs staff advised community-based organizations on strengthening their capacity to work with financial services providers and improving affordable housing and microenterprise opportunities in low- and moderate-income communities. The Bank hosted a series of regulatory roundtable discussions on new provisions of the Community Reinvestment Act, and it organized two major conferences, which together reached more than 700 community development practitioners. Additionally, the community affairs function conducted research and published reports on rural economic development, predatory lending, and access to credit and capital in low- and moderate-income communities.

#### FOURTH DISTRICT OPERATING STATISTICS

|                             | 2002          |                   | 2001          |                   |
|-----------------------------|---------------|-------------------|---------------|-------------------|
|                             | Volume        | Value             | Volume        | Value             |
| Commercial checks processed | 1,585,299     | \$ 1,493,551      | 1,538,948     | \$ 1,447,973      |
| Currency processed          | 1,111,922,668 | \$ 14,539,956,399 | 1,092,064,249 | \$ 14,179,668,069 |
| Savings bonds issued        | 9,981,873     | \$ 1,787,393,659  | 9,852,923     | \$ 1,772,809,623  |

#### PAYMENTS SERVICES

*The current financial services landscape is characterized by increased competition, rapid change, and technological innovation. As customers demand new, more efficient payment mechanisms and move away from traditional paper-based payments, the Federal Reserve has adapted by developing more sophisticated electronic payments services and by increasing its use of Web-based communications and business processes. Despite these challenges, in 2002 the Federal Reserve Bank of Cleveland continued its tradition of strong performance combined with responsive and innovative solutions to marketplace and customer needs.*

Like most of the 12 Reserve Banks, the Cleveland Bank faced significant challenges in the financial performance of its check processing function in 2002. As a result of declining check volumes, unexpectedly low interest rates, and costs associated with the Check Modernization initiative, the Bank fell short of its local net revenue target in this area. However, through a collaborative effort among Bank employees to reduce operating and discretionary expenses, the Bank was able to minimize this shortfall by year-end. Nevertheless, total revenues earned from all of the Bank's financial services exceeded its target by more than \$1 million, and the Cleveland Bank continued to rank among the Federal Reserve System's most efficient operations (measured by overall unit cost).

In partnership with the Federal Reserve Bank of Atlanta, the Cleveland Bank's Retail Payments Office continued to manage the System's Check Modernization initiative. This four-part initiative standardizes check processing at all Reserve Bank offices nationwide, implements common software for processing and researching check adjustment cases, creates a national archive and retrieval system for check images, and delivers Web-based check services to customers. Two projects—Enterprise-Wide Adjustments and FedLine® for the Web—Check Services—were completed and fully functional in 2002, and the two remaining projects—Check Standardization and FedImage<sup>SM</sup> Services—are poised for a successful finish in 2003.

As part of the Check Modernization Project, several service enhancements were launched in 2002, including a national electronic archive of check adjustments information, large-image file delivery, and a customer gateway for accessing the FedImage Services archive. These innovations provide superior check services to meet the needs of financial institutions across the country. The Retail Payments Office also took a lead role in developing more centralized product and pricing strategies across the Reserve Banks, a reflection of the increasingly national banking environment.

FedLine is a registered trademark of the Federal Reserve Banks.  
FedImage Services is a service mark of the Federal Reserve Banks.

The firm engaged by the Board of Governors for the audits of the individual and combined financial statements of the Reserve Banks for 2002 was PricewaterhouseCoopers LLP (PwC). Fees for these services totaled \$1 million. In order to ensure auditor independence, the Board of Governors requires that PwC be independent in all matters relating to the audit. Specifically, PwC may not perform services for the Reserve Bank or others that would place it in a position of auditing its own work, making management decisions on behalf of the Reserve Banks, or in any other way impairing its audit independence. In 2002, the Bank engaged PwC for advisory services totaling \$176,600 for services related to the national Check Modernization project. The Bank believes these advisory services do not directly affect the preparation of the financial statements audited by PwC and are not incompatible with the services provided by PwC as an independent auditor.

The Bank implemented two innovative electronic payments services for the U.S. Treasury in 2002. *Pay.gov* uses state-of-the-art technologies to authorize and settle government payments over the Internet; by year-end, the service was serving 14 government agencies and had processed 155,000 ACH and wire transfer transactions totaling \$3.6 billion. The *Paper Check Conversion* service, which electronically converts checks presented at the point of sale at government locations worldwide, was serving 25 agencies in 58 locations by the end of 2002, and it processed 163,000 transactions (\$78 million). The Cleveland Bank is the System's lead operating site for both initiatives. The Bank's savings bond function is the largest of the five Federal Reserve processing sites as well as the most efficient, evidenced by its lowest unit cost in the System for 2002. In 2002, this function completed the programming phase for a new processing application that will improve the efficiency and flexibility of savings bond processing throughout the Federal Reserve System.

The Fourth District's cash function led the implementation of the Standard Cash Application—which automates cash accounting, control, and reporting functions nationwide—in 11 Federal Reserve System offices. The Cleveland Bank is also home to the application's user support function. The Bank's cash processing function achieved objectives for productivity and quality, operated within budget, and maintained a low unit cost ranking within the System (third-lowest among Reserve Banks).

For a third year, the Cleveland Bank hosted a Payments Symposium, "Using New Technologies to Transform the Future of Payments." During the program, which featured nationally recognized payments industry experts from the U.S. Treasury, the FBI, and the Federal Reserve System, discussion focused on banking industry trends, the evolution of the payments system, and new products and services that are changing the way financial institutions do business. More than 130 Fourth District financial industry presidents and chief executive officers attended the symposium.

## QUALITY IMPROVEMENTS

*In 2002, the Federal Reserve Bank of Cleveland unveiled a new strategic vision: To create value for customers, stakeholders, and the Federal Reserve System by becoming a recognized leader in the evolution of central banking, the practice of banking supervision, and the development of retail payments systems. This vision will guide the Bank's operations over the next three to five years and provides a common picture of its future.*

The Bank continues to employ the balanced scorecard in all functional areas to track performance against objectives. For a second consecutive year, the Bank achieved all key System quality measures and service-level objectives.

The Cleveland Bank seeks to provide efficient and effective solutions to customers and to build valuable business partnerships. In 2002, the Bank worked to ensure a seamless transition to national service provision for its customers. To gauge its progress in meeting customer expectations, the Bank regularly surveys the financial institutions it serves. It exceeded aggressive targets for overall customer satisfaction and customers' perception of the Bank as a valued business partner, as well as the provision of flexible financial services.

In 2002, the Cleveland and St. Louis Reserve Banks joined forces in a business development merger, which combines the two Banks' sales, sales support, product development, and customer communications functions. The partnership, overseen by a regional business development team, will allow each Bank to provide superior customer sales support at a lower cost and with fewer resources while maintaining growth in the financial services industry.

The Bank launched a new public Web site in 2002—[www.clevelandfed.org](http://www.clevelandfed.org)—with improved navigation, search tools, and content organization. The design of the site makes it easier for users to locate the latest economic and financial data, research papers and Bank publications, news releases, Bank-sponsored conferences and events, background information about the Cleveland Bank and the Federal Reserve System, and consumer and financial services information.