Report from the President

REPORT FROM THE PRESIDENT

The Federal Reserve Bank of New York compiled a truly impressive record of accomplishments in 2000 in fulfilling its public policy missions and providing services to its customers. Credit for those accomplishments belongs mainly to the Bank's able staff, which reallocated resources to meet new priorities and showed a readiness to adapt to change. By working collaboratively, staff members from different business areas found creative solutions to the many economic and financial challenges we faced. In the process, new relationships were formed that position the Bank well to address future challenges.

Much of the Bank's work in 2000 involved the implementation of strategic initiatives launched the previous year. These initiatives were intended to:

- integrate financial and economic theory more effectively with the daily operations of the Trading Desk and improve understanding of how changes in the economy and financial system affect the transmission of monetary policy;
- enhance the Bank's role in financial supervision and policy formulation by strengthening our ability to identify and respond to emerging trends and public policy issues affecting the banking and financial sectors;
- promote the development of safe, efficient, and internationally linked payment systems and the formulation and implementation of payment system policy, law, and technology;
- broaden and deepen the Bank's network of international relationships.

In carrying out these efforts, the staff took on new projects that bolstered productivity and promoted cost containment. In 2000, total spending by the Bank increased only 1 percent from its 1999 level.

In the years ahead, the Bank will remain outward looking in its policies and operations and will contribute to efforts that foster financial stability, sound banking practices, and economic development. In addition, we will continue to identify ways to increase workforce diversity and use technologies to help improve productivity and contain costs. I am confident that these efforts will further enhance the Bank's reputation as the preeminent center of excellence in central banking policy and practice and as a vital link between the public and private sectors.

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IMPROVING THE OPERATION OF THE MARKETS

New technologies and the increasing growth and integration of foreign and domestic financial markets make it necessary for us to continually reassess our strategies and practices in the implementation of monetary policy. In recent years, the implementation of monetary policy has also taken place in the context of fiscal

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policy changes that have influenced the price and availability of marketable U.S. Treasury and other government securities. Thus, an ongoing challenge we face is to integrate financial and economic reasoning with day-to-day operations and to improve the flexibility and efficiency of our market operations.

Responsibility for implementing U.S. monetary policy rests with the Trading Desk at the Federal Reserve Bank of New York. Each day, the Desk uses open market operations to adjust the supply of bank reserves, meet the public's growing demand for currency, and foster monetary conditions conducive to stabilizing the federal funds rate at, or near, the level targeted by the Federal Open Market Committee (FOMC). Open market operations mainly involve the purchase or sale of U.S. Treasury securities.

As federal budget surpluses have accumulated over the last two years, the number of marketable Treasury securities has declined and their composition has changed. This development has forced the FOMC to consider altering the Desk's management of the System Open Market Account (SOMA)—the Federal Reserve's portfolio of securities—and the composition of securities acceptable as collateral in open market operations.

In March 2000, the Bank conducted the first of twenty buyback auctions held during the year on behalf of the Treasury Department, using software developed by the New York Fed staff. As a result of these operations, the Treasury Department retired a portion of its securities and reduced the indebtedness of the federal government. In addition, the Desk conducted more frequent market purchases for the SOMA and instituted a program of overlapping twenty-eight-day repurchase agreements to accommodate reserve needs resulting from the redemption of Treasury securities.

In a related effort, staff from the New York Fed participated in a broad-based Federal Reserve System review of alternative SOMA asset holdings and implemented new guidelines for the management of the approximately one-half-trillion-dollar account. These guidelines, which will help to minimize any potentially disruptive market impact of changes in the Fed's portfolio, involve a variety of actions to prevent holdings of individual issues in the SOMA from rising to undesirable levels. We announced the guidelines publicly in July and began publishing details of the SOMA portfolio on the Bank's web site weekly, furthering our goal of being transparent about our operations.

Early in 2000, the lingering effects of the pre-Y2K adjustments required the attention of both the FOMC and the Bank. The FOMC ended the special financing facility that it had created in 1999 in anticipation of the century date change. The facility, which authorized the Desk to sell options on temporary repurchase agreements, was designed to avert tight conditions in the capital markets critical to monetary policy operations. At its March 2000 meeting, the Committee made permanent the Desk's authority to use reverse repurchase agreements in addition to matched sale-purchase transactions to absorb reserves on a temporary basis. The FOMC also extended its authorization for an expanded pool of collateral to be accepted in the Desk's repurchase transactions through its first meeting in 2001; at that meeting, on January 31, 2001, the FOMC again extended its temporary authorization. The principal effect of this action was to continue the inclusion of pass-through mortgage securities of Ginnie Mae, Freddie Mac, and Fannie Mae and of stripped securities of government agencies as acceptable collateral in repurchase agreements. This extension was intended to guard against undesirable financial market repercussions that could arise as marketable Treasury debt declined.

One important consequence of the Bank's adjustments to the government's changing fiscal position has been the building of even closer ties with the Treasury Department. In 2000, for example, the New York Fed assisted the Treasury in the development of new rules for noncompetitive auction bidding by foreign official accounts to limit bids at each auction. Following the Treasury rule changes, Bank staff spent considerable time preparing account holders operationally for the implementation of the rule changes. The staff also introduced new automated systems for the collection and processing of data on the Treasury's cash flows and the investment of its balances in the Treasury tax and loan system. The Bank's own systems for forecasting reserves were also modified in conjunction with these changes.

The Markets Group continued to fulfill its responsibilities to the System and the Treasury by implementing foreign exchange policy and managing the foreign currency reserves of the U.S. monetary authorities. In September 2000, the foreign exchange trading desk intervened in the currency market on behalf of the U.S. monetary authorities for the first time in more than two years and only the second time in five years. The intervention employed the new trade processing system (TPS) foreign exchange (FX) module, which greatly improved operations. The automated capture of broker trades, trade confirmation with counterparties, and issuance of payment instructions with the TPS FX module sharply reduced operational risks and the staff time required to process the intervention.

Our foreign exchange staff also completed analyses that laid the groundwork for an eventual diversification of the Fed's portfolio of euro-denominated government securities. With this diversification, the Fed's holdings of government securities purchased outright or acquired under repurchase agreements will be expanded to include the obligations of a broader range of countries.

During 2000, the Markets Group undertook a comprehensive review of its accounting and control systems, drew on internal resources from around the Bank to build its expertise, and initiated several programs to heighten awareness of internal controls among its staff members. Accounting processes for the implementation of the TPS FX module were also reviewed. In addition, the staff launched several initiatives designed to improve the group's quality control environment. As a result of these efforts, new risk mitigation procedures were implemented.

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Late in 1999, the Bank undertook a fundamental reassessment of the organizational structure of its Bank Supervision Group, and in 2000 it adopted a new structure and staffing model.

In 2001, the Bank's Markets Group will continue to work with the Research and Market Analysis Group to integrate financial and economic reasoning with day-to-day operations and improve the Bank's understanding of market behavior. In so doing, these groups will analyze which asset prices are most informative about Federal Reserve policy expectations and transmission mechanisms, how globalization and consolidation affect the monetary policy transmission mechanism, and what role monetary policy plays during periods of financial stress. The two groups will also continue to analyze the implications of the declining supply of U.S. Treasury securities for monetary operations, assist the Treasury Department in developing debt management strategies, and consult with our foreign central bank customers about the management of their portfolios of Treasury securities.

SUPERVISION AND REGULATION: A NEW LOOK

As the supervisor and regulator of bank holding companies, financial holding companies, and various other banking organizations, the Federal Reserve seeks to promote the safety and soundness of the banking system and to assess compliance with banking laws and regulations. This is accomplished primarily through periodic examinations of supervised institutions, ongoing monitoring and surveillance, and identification of emerging supervisory risks.

Late in 1999, the Bank undertook a fundamental reassessment of the organizational structure of its Bank Supervision Group, and in 2000 it adopted a new structure and staffing model. The reorganization was undertaken in response to the increasingly complex operations of the institutions we supervise and the growing specialization in the banking industry. We believe that the new organizational model helps us to meet several long-term goals of the Supervision Group—improved management of relationships with supervised institutions and other regulators, the development of stronger expertise in specific areas of financial risk, a better understanding of risks and of sound practices across a range of institutions, and early identification of emerging supervisory issues. Another goal of the reorganization was to promote individual career development by providing staff with a significant voice in their assignments under the new structure and by fostering staff mobility within the group.

By the end of 2000, we were well on our way to meeting these goals. Further, the Bank established itself as the Federal Reserve System's focal point for developing expertise in, and overseeing reviews of, banks' economic capital allocation methodologies. The new structure also provided flexibility to adapt to new business developments and to contribute effectively to the formulation of supervisory policy. In 2000, it allowed us to evaluate more effectively the skills and training needs of our supervisory staff and to identify resources that can be used to implement financial reform legislation.

In a broader policy forum, the Federal Reserve Bank of New York played a critical role in 2000 in support of my work as chairman of the Basel Committee on Banking Supervision.

The Bank's staff provided substantial leadership in the development of the second consultative paper of the Basel Capital Accord. Personnel from several areas of the Bank served on the Committee's working groups, prepared proposals for specific elements of the new capital regime, led the effort to compare and evaluate credit rating agency practices, and helped draft the final documents released by the Basel Committee.

The second consultative paper presents a capital adequacy framework that rests on three pillars. The first pillar focuses on minimum capital requirements adjusted to be more sensitive to risk. The second pillar emphasizes the role of banks in assessing their own capital needs in excess of regulatory minimums and the role of supervisors in reviewing the efforts of banks to achieve the right balance of capital relative to risk. The third pillar of the new framework stresses the role of market discipline in maintaining prudent capital ratios through the encouragement of increased disclosure and transparency.

Under the terms of the Gramm-Leach-Bliley financial reform legislation of 1999, the Federal Reserve is the umbrella supervisor for financial holding companies, which are permitted to engage in a broad range of financial activities. The Bank's Supervision Group took an active part in System efforts to implement the legislation—most notably, by helping to frame the basic objectives of umbrella supervision and to establish a structure for coordinating operations with other functional supervisors. By year's end, efforts to form and enhance working relationships with local financial supervisors were well under way.

Our Bank has been proactive in identifying and responding to emerging risks, particularly those related to global banking organizations. An interdisciplinary Bank Risk Council—drawing its participants from Bank Supervision, Emerging Markets, Markets, Research, and Financial Services—assessed credit conditions and operational and other emerging risks in the domestic and international financial sectors. In addition, in conjunction with staff of the Board of Governors, Bank staff studied geographic banking markets and developed a model to assess the pricing of sub-prime debt.

Our Bank has been proactive in identifying and responding to emerging risks, particularly those related to global banking organizations.

In 2001, the Bank will continue to look for ways to strengthen its leadership in financial supervision. To do so, we must build our interdisciplinary capacity to identify and respond to emerging trends and public policy issues affecting the financial and banking sectors. In line with this goal, we will undertake to implement an effective supervisory approach to e-commerce and Internet banking. We will also pursue efforts to make umbrella supervision more fully operational across the range of firms we supervise.

In addition, the Bank will support the implementation of the revised Basel Capital Accord, playing a key role in domestic and international efforts to educate banks and supervisors about the implications of the new Accord and laying the groundwork for its introduction in the United States. In this connection, we will expand our review of how banks manage their credit risk on a portfolio

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basis, with a focus on evaluating internal rating systems and stress testing portfolios, and develop new examination procedures that address internal rating systems. Further, the Bank will work to improve its monitoring of the industries that are most sensitive to a cyclical downturn and that therefore pose the greatest risk to the banking system. Finally, we will continue to build our staff's skills and to adapt to the changing business profiles and specialization strategies of the organizations we supervise.

GAINING EFFICIENCY IN PAYMENT SYSTEMS

I am particularly pleased by the improved financial and operating performance of our check operation in 2000. A comprehensive multiyear reform plan encompassing more than twenty separate components was implemented. Phase I of that plan for 2000 produced significant improvements in the operation's net revenue, unit cost, and productivity performance. These improvements were rooted in our application of resource-allocation modeling and scheduling tools to various work processes, our adoption of selected industry "best practices," the restructuring of a number of internal support service operations, and a concerted effort to contain overhead costs. Savings from these actions helped the Bank to post the best net revenue performance for check operations it has ever achieved. Moreover, the Bank was able to keep its prices for local check services unchanged in 2001.

Over the long term, the performance of the Bank's check operation will depend largely on the growing deployment of modern technologies in both Federal Reserve and commercial banks' check operations and on greater acceptance of check imaging by the public. We view check imaging as a "bridge" technology with the potential to accelerate the movement from paper payments to electronic payments. With check imaging, banks process and transmit an electronic image of each check rather than the paper check itself.

In 1999, we successfully tested the capabilities, speed, and reliability of state-of-the-art check imaging technology at our Utica office. We also found that commercial banks that use our imaging services could capture efficiencies and cost savings in their own back-office check operations. In 2000, we completed the second phase of our check imaging project when all five high-speed reader sorters at our Utica office were image-enabled and put into operation. In a parallel effort, our business development office encouraged private sector bankers to adopt check electronification—an initiative that contributed to a 23 percent rise in the number of customers using Utica's imaging services. This year, the Bank expects to satisfy pent-up demand for these services from scores of New York area banks that want to convert customers' checks into imaged items. We also plan to maximize the internal operating efficiencies that image processing permits by reengineering our check reconcilement and adjustment operations.

In our cash operations, the Bank's continued leadership in the international distribution of U.S. currency helped meet growing global demand. We expanded the Federal Reserve's extended custodial inventory (ECI) network by establishing an eighth ECI site, in Buenos Aires, and we renewed agreements with all five of our European ECI site operators. Through the ECI program, we house U.S. currency in cash depots at banks abroad in order to facilitate currency distribution and to ensure the quality of paper money. With ECIs now operating in Asia, Europe, and South America, we have created a global network that enables us to manage the international distribution of U.S. currency more effectively and to assist the Secret Service in detecting counterfeiting of U.S. currency abroad. It is estimated that about two-thirds of outstanding U.S. currency circulates outside the United States.

Early in 2000, the Bank faced the difficult challenge of managing the rapid redeposit of extra currency put into circulation before the century date change. By late winter, we had taken back almost all of the cash held by depository institutions that had anticipated a surge in the public's demand for banknotes. We had also taken back the extra currency we had positioned at the domestic and international strategic inventory locations we had established in 1999 for Y2K contingencies. Both operations were completed without any losses or increases in cost.

Major challenges for cash operations in 2001 will be to advance a range of automation initiatives giving customers easier access to account and ordering information, to complete the establishment of off-site coin terminals, and to boost overall productivity while further containing costs.

In 2000, the Federal Reserve Bank of New York undertook to gain a better understanding of emerging electronic payment practices and trends and to determine how financial institutions are responding to them. As part of that work, New York Fed staff evaluated a range of new electronic bill payment and presentment programs, met with banking and Internet leaders, gathered market data, and began assessing the policy and operational implications of the growing trend toward Internet banking.

In addition, we contributed to a number of major initiatives directed toward strengthening the infrastructure of the electronic payment systems that increasingly link U.S. and international markets. These initiatives included the conversion to a shorter settlement cycle for domestic securities transactions and the formation of the CLS (Continuous Linked Settlement) Bank for foreign exchange settlements. We worked with the Group of Ten central banks' Committee on Payment and Settlement Systems (CPSS) to develop core principles for payment systems, reduce foreign exchange settlement risk, analyze the design of retail payment systems, and, as part of a joint project with the CPSS and the International Organization of Securities Commissions, formulate recommendations for securities settlement systems. Research efforts included a study of the intraday liquidity demands of real-time gross settlement payment systems and a study of the implications of business-to-business nonfinancial e-commerce for financial services companies.

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The Bank's broad mandate and unique position at the crossroads of the public and private spheres require that we maintain strong relationships with a wide range of official and private sector representatives both at home and abroad.

In 2000, the System's Wholesale Payments Product Office (WPPO), which is located at the Bank, continued to build alliances to maximize improvements to the payment system. It completed projects to identify and recommend changes to the Fedwire funds transfer service that will improve the efficiency of customers' wholesale payment operations. In particular, through interviews with customers, software vendors, and international organizations, the WPPO identified enhancements that will reduce manual intervention in transactions and thereby limit the potential for errors. This "straight-through" processing project resulted in several changes to the funds transfer message format.

The WPPO also developed a multiyear technology strategy to enable wholesale-service customers to access Fedwire services using the Internet protocol. In addition, the WPPO identified opportunities for service streamlining and consolidation. A complete review of the wholesale service infrastructure is planned for 2001.

After Ginnie Mae decided in 2000 to move its securities to Fedwire, the WPPO worked with the Bond Market Association, members of the U.S. government securities dealer community, and the Depository Trust and Clearing Corporation to coordinate and plan the move of the securities to Fedwire during 2001.

Responding to developments such as financial sector consolidation and expanded Internet use, the Bank has sought to provide innovative services to the Treasury Department and to banks. In 2000, we expanded the international direct deposit (IDD) program that we provide for the Treasury from twelve countries to thirty-seven countries. Through the IDD program, the Federal Reserve, acting on behalf of the Treasury, makes repetitive payments electronically to U.S. citizens. Our IDD expansion, coupled with a new contract we established with banks in Canada and Ireland, enabled us to provide more cost-effective dollar payments to U.S. citizens living in those two countries.

STRENGTHENING INTERNATIONAL RELATIONSHIPS

The Bank's broad mandate and unique position at the crossroads of the public and private spheres require that we maintain strong relationships with a wide range of official and private sector representatives both at home and abroad. Building on these relationships, the Bank plays an active role in monitoring, analyzing, and ameliorating incipient economic pressures, and in contributing to policy discussions to promote increased financial stability in the domestic and international arenas.

In 2000, the Bank completed extensive analyses of economic and financial issues in both developed and emerging market countries. We mustered our internal resources to monitor developments of potential significance to the United States and to gain a better understanding of topical issues in international trade and finance. Members of the Bank's Research and Market Analysis Group closely followed the evolution of common-currency financial markets in Europe and published a set of studies identifying the lessons learned from the 1997-98 Asian economic and financial crises. In addition, the Research Group studied issues as varied as the sustainability and financing of the U.S. current account deficit, international differences in productivity growth, the prospects for international transmission of financial market shocks, and recent and prospective dynamics of major exchange rates.

Strong and improving relationships with the U.S. government and international financial institutions enabled the Bank to play an active consultative role when foreign countries experienced significant financial stress during 2000, and when complex policy issues such as private sector involvement in sovereign liquidity crisis management faced the international community. Relationship-building efforts overseas improved significantly, particularly with countries adjusting to new or changing administrations, permitting the Bank to maintain continuity of relationships during critical periods for a number of countries. In addition to taking part in regular and ongoing consultations with other central banks on a wide range of issues, the Bank also engaged in several targeted central bank outreach initiatives during 2000.

Recognizing that foreign capital has been an important, if not always sufficiently accessible, source of financing for emerging market countries, the Federal Reserve Bank of New York and the World Bank cosponsored an international conference in Mexico City to discuss how countries might change their laws and legal systems to promote increased foreign investment. Conference participants came away from the conference with a better understanding of the importance of modern bankruptcy laws for investors considering whether to place their capital at risk in a particular country.

Financial crises in many parts of the world during the past decade reinforced the need for strong central banks. In that context, the New York Fed continued to extend and improve its training and technical assistance effort on several continents in 2000. We conducted extensive on-site training for central bankers in Africa, Latin America, and other emerging economies, working through alliances and cooperative efforts with regional central banks and training institutions. The Bank also identified opportunities to provide technical assistance to countries where the Bank has a strategic interest. In 2001, we will extend our training efforts further, with a special focus on sub-Saharan Africa.

The Bank held training sessions in New York (including field experience) for staff from several central banks and organized a number of programs for individual central banks and regional monetary institutions. The Bank hosted its annual two-week seminar for central bankers, which featured customized activities for more than 180 foreign central bankers and other representatives from a range of countries. Specialized courses included presentations on supervisory matters, portfolio management, payment systems, management and operations, and monetary policy, and were led by senior-level speakers from within the Bank and elsewhere in the financial community.

In 2001, the Bank will seek to deepen and expand international relationships that provide a foundation for our efforts to promote financial stability. To accomplish this, we will continue to leverage our expertise in monetary policy, financial markets, bank supervision,

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and payment systems to promote stronger central banking in emerging market countries. In addition, our staff will strive to expand the research it produces on the economies of developed and emerging market countries.

CONTRIBUTING TO PUBLIC POLICY DISCUSSION

Since becoming president of the Bank in 1993, I have been fortunate to have the support of an outstanding team of economic and financial researchers. Each day, the Bank's Research and Market Analysis Group provides the Bank's senior officers with the information and analyses we need to make informed judgments and management decisions. Further, the Research Group's work supports the missions of most other groups in the Bank, contributes to public policy discussions outside the Bank, and enhances the Bank's prestige as a center for world-class research on policy issues. Collaboration between the research economists and staff from other areas of the Bank makes our research products relevant, timely, and useful both to our management and to economic and financial market practitioners elsewhere.

In 2000, the Bank's economists completed a sizable body of original research on domestic economic and business conditions, international trade and development, banking, capital markets, and the payment system. This research helped to stimulate discussion of policy issues while also improving the public's understanding of economics, finance, and central banking. Academic journals and other scholarly volumes, including some of the most prestigious journals in the world, published or expect to publish almost 100 studies written by New York Fed economists, 20 more than in 1999. Readership of the research published by the Bank increased dramatically from 1999 levels, in part because of improvements in the Bank's Internet site that simplified the search for particular publications and topics.

In addition to maintaining a strong tradition of publishing first-rate research, the New York Fed monitors local and regional economic conditions and promotes policy actions that foster economic and community development. Our outward perspective is enhanced greatly by information we receive from members of nonprofit and educational organizations and from our advisory councils. By taking leadership positions on educational and community development issues such as mortgage financing, entrepreneurship, and the school-to-work transition, the Bank benefits from the perspectives of outside experts while promoting discussion and grassroots actions.

In 2000, the Bank completed a survey of small business owners in the tri-state region to determine the stimuli and impediments to their business expansion. Results of the survey, the first in a series looking at regional economic development needs, were published and presented to government officials for consideration in making policy decisions. The Bank also published several regional economic analyses and participated in forums with state and local officials on the economic outlook and other policy considerations.

In addition, the Bank upheld its commitment to fostering discussion and debate by hosting a number of conferences on public policy issues. We hosted a conference that identified corporate governance standards and strategies most likely to improve a firm's performance and facilitate the work of regulators and members of the investment community engaged in evaluating the strengths and weaknesses of corporations. A conference at the Bank on welfare reform brought together academicians, policymakers, and community groups for a spirited discussion of the progress made since the landmark reform legislation of the mid-1990s. To expand our contact with communities, we cosponsored conferences in Newark, New Jersey, on the dynamics of urban revival, and in New Paltz, New York, on the outlook for the economy of the Mid-Hudson Valley. We also cosponsored a conference and related roundtable discussions that highlighted strategies for bridging the gap in information technology skills between low- and high-income areas.

The Office of Regional and Community Affairs (ORCA) continued to support the Bank's policy objectives by promoting broad access to credit and economic development opportunities that enhance economic stability in Second District communities. In fulfilling this mission in 2000, ORCA disseminated information and used its convening power to help create partnerships aimed at addressing community needs. ORCA conducted more than 110 interviews with bankers, community groups, and government officials in upstate New York and New Jersey to hear about their needs and to listen to their proposals for improving economic well-being in their communities. Drawing on ORCA's findings, the Bank forged significant new relationships and began to develop projects that focus on workforce development and housing.

In 2000, the New York Fed also undertook a range of initiatives to improve economic and financial literacy, particularly among educators and young people. Especially notable among these efforts was a program to train Puerto Rican high school teachers in the basics of economics and finance. Between 1998 and 2000, some 160 teachers from 125 schools participated. Working with the New York State Department of Education, staff from our Public Information department wrote the syllabus for a new, mandated high school economics course that will be introduced in September 2001, and led a public-private consortium that began training educators to teach it. The Bank enrolled a record number of schools in its economics competitions and established the Wall Street Finance and Economics Club, a new program intended to introduce youths from schools in low- and moderate-income areas to work in the financial sector.

Staff from the Bank headed the New York State JumpStart Coalition in 2000 and took leadership roles with the National Partners for Financial Empowerment, both of which promote youth financial literacy. In addition, the Bank was a key participant in the New York City Financial Partnership for Youth, a program in which financial firms provide internships and jobs to high school students from low- and moderate-income communities.

MANAGEMENT IMPERATIVES

Late in 2000, the Bank embarked on a major new effort to improve and expand the ways we

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use the Internet and associated technologies to reach our business goals. While many areas of the Bank already use the Internet effectively, others have not fully tapped its potential to enhance customer service, reduce costs, and improve the work of individual employees. We formed a task force to identify impediments to the use of the Internet and related technologies and to develop training and incentive programs to foster a stronger culture of change through automation. Further, we encouraged business areas to be aggressive in applying technology to transform their operations, bolster efficiency and productivity, and contain costs.

Over the next several years at least, the Bank's management will continue to work intensively with all employees to find better, faster, and less expensive ways to fulfill their missions. In 2000, we realized such efficiencies through the adoption of web technologies, enhancement of electronic security, upgrading of infrastructure, and development of new applications. Our automation staff implemented important new standards and best practices related to the development and production of web applications.

The automation staff also played a major role in facilitating technological advances Bankwide. Significant progress was made in minimizing the complexity of desktop configurations throughout the Bank, an achievement that should help the Bank realize its goal of reducing the unit cost of workstations that use the Bank's computer network. Automation staff completed a multiyear effort to transfer network mainframe monitoring to the Federal Reserve's consolidated mainframe processing center. In addition, the staff helped coordinate the System's Fednet modernization initiative to overhaul the nationwide communications infrastructure.

A key component of the Bank's plan to upgrade the ways it does business involves more effective use of the space we occupy at all of our sites. In 2000, we continued our multiyear modernization of the headquarters building by finishing the sixth of our high-occupancy floors, and by the end of 2003, the remainder of our major floors will be completed. Restoration of the facade of the headquarters building continued in 2000 with the cleaning of most of the exterior stonework. This effort revealed the beauty of the limestone and sandstone facade and further heightened the pride New York Fed staff feel in their landmark workplace.

While improvements to infrastructure, technology, and the workplace were significant accomplishments in 2000, the achievement of our ambitious goals depends overwhelmingly on our ability to attract and retain highly skilled staff. To that end, we expanded and refined our recruitment efforts, particularly through Internet-based recruiting tools. We also took steps to enhance the competitiveness of our compensation packages, with a strong emphasis on attracting and retaining top performers and providing support for occupations experiencing significant market pressures. I am confident that, owing in part to these efforts, the Bank will continue to have a first-rate staff capable of meeting all the challenges ahead.

To succeed in the coming years, every area of the Bank must work confidently and innovatively, and must be willing to experiment with new projects and new ways to bring those projects to fruition. Fulfilling this vision, however, will require effective leadership from all members of the Bank's management team. To foster more effective leadership, the Bank introduced a leadership development initiative in 2000 that will be the centerpiece of our training and development efforts. Within the context of that initiative, we will strive to ensure that all staff members feel involved and valued and have the opportunity to contribute to the full extent of their abilities. The program will also further encourage staff in diverse areas of the Bank to work together, to embrace change, and to strive for higher productivity by taking advantage of technology.

To increase productivity, the Bank will also provide all business areas with the capability and funding to undertake new initiatives and operate more flexibly. As we go forward, therefore, we must bring new technologies into our work at every level of the organization and adopt the best practices of both the public and private sectors to transform the ways we do business. Jamie Stewart, the Bank's First Vice President, and I fully support efforts throughout the Bank to take bold steps that foster a culture of change and improvement that will strengthen the Bank's position as a leader in central banking. In light of the Bank's solid record of achievement in 2000, I have no doubt that, during the years ahead, the Bank and its staff will take maximum advantage of the opportunities to heighten efficiency, boost productivity, and contain costs through the effective use of modern technologies.

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February 8, 2001

To the Board of Directors of the
Federal Reserve Bank of New York:

The management of the Federal Reserve Bank of New York (FRBNY) is responsible for the preparation and fair presentation of the Statement of Financial Condition, Statement of Income, and Statement of Changes in Capital as of December 31, 2000 (the "Financial Statements"). The Financial Statements have been prepared in conformity with accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System and as set forth in the Financial Accounting Manual for Federal Reserve Banks, and as such, include amounts, some of which are based on judgments and estimates of management.

The management of the FRBNY is responsible for maintaining an effective process of internal controls over financial reporting, including the safeguarding of assets as they relate to the Financial Statements. Such internal controls are designed to provide reasonable assurance to management and to the Board of Directors regarding the preparation of reliable Financial Statements. This process of internal controls contains self-monitoring mechanisms, including, but not limited to, divisions of responsibility and a code of conduct. Once identified, any material deficiencies in the process of internal controls are reported to management, and appropriate corrective measures are implemented.

Even effective internal controls, no matter how well designed, have inherent limitations—including the possibility of human error and costs versus benefits considerations—and therefore can provide only reasonable assurance with respect to the preparation of reliable financial statements.

The management of the FRBNY assessed its internal controls over financial reporting, including the safeguarding of assets reflected in the Financial Statements, based upon the criteria established in the "Internal Control–Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, the management of the FRBNY believes that the FRBNY maintained an effective process of internal controls over financial reporting, including the safeguarding of assets as they relate to the Financial Statements.

William J. McDonough
President

Jamie B. Stewart, Jr.
First Vice President

Report of Independent Accountants

PricewaterhouseCoopers L.L.P.

To the Board of Directors of the
Federal Reserve Bank of New York:

We have examined management's assertion that the Federal Reserve Bank of New York ("FRBNY") maintained effective internal control over financial reporting and the safeguarding of assets as they relate to the Financial Statements as of December 31, 2000, included in the accompanying Management's Assertion.

Our examination was made in accordance with standards established by the American Institute of Certified Public Accountants, and accordingly, included obtaining an understanding of the internal control over financial reporting, testing, and evaluating the design and operating effectiveness of the internal control, and such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal control over financial reporting to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assertion that the FRBNY maintained effective internal control over financial reporting and over the safeguarding of assets as they relate to the Financial Statements as of December 31, 2000, is fairly stated, in all material respects, based upon criteria described in the "Internal Control–Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission.

PricewaterhouseCoopers LLP

New York, New York
March 2, 2001