
Letter from the President

LETTER FROM THE PRESIDENT

Outreach in 2011

Seeking the perspectives of others
as we pursue our mandate

Over the past year, I have been on the road a great deal. I have spent roughly a hundred days out of the office, traveling to meetings and discussions throughout the Second District, around our nation, and to points abroad. With all the urgent work in which the Bank is engaged, I never make the decision to spend time out of the office lightly. My decisions to travel reflect the fact that we at the Bank cannot do our jobs in a vacuum. The work that we do within the Bank has to be inspired by, and to reflect, the perspectives of many.

As part of this effort, I have reached out to a broad set of constituents so that our deliberations and actions will be informed by the full spectrum of interests, issues, and views relevant to the responsibilities that the American people have entrusted to the Federal Reserve. Our mandate is to achieve maximum sustainable employment in the context of price stability. Part and parcel with this mission is the need to make the financial system more resilient and robust so that it can perform its essential role of supplying credit to the real economy even in the face of severe shocks.

As we carry out our mission, many of our engagements will inevitably be with financial

institutions, whether it be the banks that we regulate or those that we deal with in the implementation of monetary policy. This is appropriate, as we cannot fulfill our public interest responsibilities if we do not deeply understand what is happening within our rapidly evolving financial system.

But we cannot do our work properly if we do not go beyond such engagements. Accordingly, we have continued to expand our efforts to seek out the broader communities affected by our work. These include members of the general public, leaders of businesses large and small, academics, community development groups, and state and local government officials.

We have talked with stakeholders throughout the communities of the Second District—from Albany to the Bronx, from Newark to San Juan. As we engaged with these communities, we found a genuine interest in what the Bank does and how and why we do it. These visits have helped me to gain a better understanding of the problems households and businesses face in coping with difficult economic circumstances and have encouraged me to do all that I can to ensure that we do the best possible job for these communities. This intelligence has also provided us with valuable external insights to inform the economic and policy analysis we conduct on issues such as credit supply, housing, and the job market in support of our mission.

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The National and Regional Economies and Monetary Policy

Addressing ongoing challenges in the U.S. economy

The year 2011 saw a bright start for the U.S. economy as risks of a double-dip recession or possible deflation were staved off, in part by the Federal Reserve's actions. Unfortunately, this promising beginning gave way to more uncertain progress as we faced several obstacles to a robust recovery. Among these were spillover from the stresses in Europe, ongoing household deleveraging, tightness in the supply of credit to some parts of the economy, and continued drag from the problems in the housing sector.

On the positive side, the recovery appears to have become better established. However, the sustained quickening in the pace of recovery typical of most expansions following deep recessions has remained elusive, and the economy has continued to operate far below reasonable estimates of its productive capacity.

Throughout this period, the outlook and risks facing the U.S. economy were significantly influenced by developments in Europe. Bank staff provided Federal Reserve policymakers with substantial analysis and insight into European issues. In addition, the Bank took important steps, pursuant to the direction of the Federal Open Market Committee (FOMC), to strengthen currency swap arrangements with other central banks. The swap lines were established to support the flow of credit to U.S. households and businesses. They enabled central banks in Europe and elsewhere to provide financial intermediaries access to dollar funding so that they could continue to support their dollar lending activities.

The Second District's economy improved overall in 2011. New York City saw solid growth, while New Jersey's recovery, which only really began to take hold in 2011, gathered momentum over the course of the year. However, some parts of our District, particularly Puerto Rico, have been slow to recover.

■ Advancing policy goals through balance sheet actions and communications efforts

With the traditional tools of monetary policy still constrained by the zero lower bound on interest rates, the Federal Reserve made use of other tools to stimulate the economy. These included communications efforts and balance sheet actions in which the Bank was deeply involved. These initiatives were designed to make financial conditions easier and more supportive of growth in economic activity.

In 2011, the Markets Group completed the Federal Reserve's second large-scale asset purchase program, known by most as "QE (quantitative easing) 2," and continued to reinvest principal payments from agency debt and mortgage-backed security holdings into longer-term Treasury securities. Later in the year, under the direction of the FOMC, the Markets Group began a program to extend the maturity of the System Open Market Account Treasury securities portfolio and shifted the reinvestment of principal payments from agency debt and agency mortgage-backed securities to mortgage-backed securities. These programs required intensive open market operations and were implemented successfully, without any meaningful disturbance to financial markets. Bank staff also contributed significantly to the FOMC's discussions of monetary policy implementation—for example, with respect to how best to improve

understanding of the likely future course of monetary policy.

■ Supporting the recovery

Although monetary policy plays a key role in supporting recovery, there is clearly much more to economic policy than monetary policy alone. To achieve the best possible recovery, we also need action in areas such as housing policy, fiscal sustainability, and structural reform across a broad front, including labor markets, infrastructure, and trade.

By late 2011, the unemployment rate finally began to fall at a more rapid pace. This trend has continued into 2012. However, the pace of the improvement in the unemployment rate overstates the progress in the labor market as a whole, and we remain a long way from generating enough activity to absorb the nation's currently idled labor resources. At the same time, both public and market-based measures of long-term inflation expectations have remained firmly anchored at levels consistent with our 2 percent inflation objective. The stability of inflation expectations is critically important for both sides of our mandate. Inflation expectations influence the actual rate of inflation that is likely to prevail in the future. Moreover, it is the stability of inflation expectations that gives us the capacity to pursue stimulative policies in response to shocks that depress economic activity and employment below sustainable levels. I am completely committed to keeping inflation low and inflation expectations stable.

Our Own Financials

Seeing continued expansion in 2011, with normalization ahead

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and the System Open Market Account portfolio managed by the Bank on behalf of the Federal Reserve System. This enlarged balance sheet, combined with near-zero interest rates on reserves, resulted in unusually high Federal Reserve System net income and remittances to the Treasury. System remittances were \$75 billion over the course of 2011, of which the Bank's share was \$32 billion. These remittances are exceptionally large and are expected to fall in the future once the stance of monetary policy and the size of the Federal Reserve's balance sheet normalize.

■ Achieving a successful exit from crisis-era interventions

The Bank's financial statements also reflect progress in winding down many of the interventions deployed to combat the financial crisis and restore financial stability. In January 2011, the Bank terminated its lending facility to American International Group, Inc. (AIG), as AIG fully repaid the Bank's crisis-era loans to the company. The repayment represented the culmination of efforts to stabilize AIG.

Later in 2011, the Bank began a competitive process of selling down the holdings of Maiden Lane II LLC, a facility established by the Bank in 2008 to acquire certain residential mortgage-backed securities from AIG's insurance subsidiaries that were destabilizing to AIG at that time. This process, completed in early 2012, delivered an overall profit for the Bank, and ultimately for the taxpayer, of approximately \$2.8 billion.

With leadership from the Bank's Investment Support Office, two of the Bank's other crisis-era special facilities, Maiden Lane LLC and Maiden Lane III LLC, continued to perform well. While the future is inherently uncertain, at

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present we are confident that the two facilities will also be paid off in full, with no loss to the Bank and with profits for the public.

The Term Asset-Backed Securities Loan Facility (TALF)—a crisis-era intervention that focused on sustaining the supply of consumer and business loans by supporting the securitization markets for these loans—also continues to perform well. As of the end of 2011, the outstanding balances were continuing to decline rapidly as many loans were pre-paid and no losses were recorded on any of the loans.

Profit has never been the objective of these extraordinary interventions. Their purpose was to stabilize the financial system and limit the damage to the real economy, households, and businesses. The real payoff has been in the nation's gradual return to economic growth and a more normal credit supply. But the Bank's ability to realize value as a by-product of its actions is testimony to the skills and dedication of the Bank staff who managed these efforts.

Regulation and Financial Stability

Reengineering the focus of the Financial Institution Supervision Group

Ensuring the ongoing stability of the financial system is a crucial aspect of a central bank's work. Put simply, we cannot be successful in achieving our dual mandate if the availability of credit to households and businesses is disrupted in times of stress. With the memory of the most recent financial crisis still fresh in our minds, the Bank was extraordinarily active on a number of financial stability issues in 2011.

The Bank took important steps to assist in reengineering the supervisory approach taken to the nation's largest financial firms. The Financial Institution Supervision Group (FISG) set in

motion a far-reaching internal transformation designed to strengthen its focus on sources of systemic risk at the largest and most complex financial firms. FISG implemented a variety of mechanisms designed to ensure that we maximize the Federal Reserve's greatest advantage—its ability to compare risk management practices across firms on a consistent basis. Further, we have appointed a larger number of senior Federal Reserve executives to lead on-site teams at large, systemically important financial institutions. As a complement to this step, we have placed greater emphasis on communicating supervisory guidance directly to each firm's senior leadership and to the independent members of its board of directors.

■ Advancing other System financial stability efforts

At the same time, the Bank has continued to make substantial contributions to the Federal Reserve System's other efforts to ensure a more stable financial system. Work to implement the Dodd-Frank Act continued throughout 2011. Bank staff worked to make financial institutions more resilient to unforeseen developments in several ways—for example, by strengthening and extending capital planning processes and by developing bank recovery and resolution plans. The latter initiative is designed to provide troubled firms with a roadmap of actions that might help them recover strength or permit their orderly wind-down.

One of the most important initiatives that the Bank engaged in is the Comprehensive Capital Analysis and Review (CCAR) process—the first cycle in 2011 and the second in 2012. This exercise represents a leap forward in the Federal Reserve's supervision of large financial firms. The CCAR requires large bank holding companies to develop and maintain robust,

forward-looking capital planning processes to help ensure that they have sufficient capital to continue operations during periods of economic and financial market stress. Bank staff made enormous contributions to the development and successful execution of the CCAR in 2011 and 2012, and I expect that Bank staff will continue to play a leadership role in innovating and refining our methodology for stress testing as this effort evolves in the future.

■ **Actively working with international and domestic groups to promote financial stability**

My Bank colleagues and I have been deeply involved in international efforts to secure financial stability. These efforts include work to strengthen both market infrastructures and the largest financial institutions. As chairman of the Committee on Payment and Settlement Systems of the Bank for International Settlements, I worked with other central bankers and practitioners around the globe to establish new principles for financial market infrastructures. If we are to achieve our financial stability objectives, it is essential that such principles be adopted on a consistent basis across all the world's major financial centers.

This year I am taking on new responsibilities as the chair of the Committee on the Global Financial System, a committee of central bankers dedicated to identifying and assessing the sources of systemic risk in the global financial system and to fostering financial stability.

Meanwhile, Bank staff have been working on strengthening banks and other financial institutions by contributing to the design of the Basel III international capital requirements and liquidity standards. These standards, too, need to be consistently applied around the world if we are to achieve our objectives.

At home, we pressed on with our efforts to strengthen the tri-party repo market, a source of vulnerability during the financial crisis. We secured some progress with a private sector-led task force, but made it clear that we are now proceeding to a regulatory phase in which we will use our authority to promote a more far-reaching overhaul of this market.

■ **Collaborating across the Bank to achieve financial stability goals**

We made important strides in 2011 on financial stability and financial regulation, but much remains to be done. I see financial stability as an ongoing commitment that requires continued collaboration across the Bank and the Federal Reserve System and with external stakeholders in the United States and abroad. To support and coordinate current and future initiatives in these areas across the Bank's groups, the Bank created a new Office of Financial Stability and Regulatory Policy. From the crisis, we learned that new risks constantly emerge and mutate in the financial system and we must stand prepared to identify these risks on a cross-Bank basis. To this end, we need a financial stability focus in all our work, facilitated by an open flow of information throughout the Bank. The newly formed office is designed to enable us to meet this objective.

Culture and Management

Striving for excellence

The Bank is a special place, with a strong culture of excellence and an abiding and widely shared commitment to the public interest. Over the past year, we have been working to advance our internal capabilities to ensure that the Bank can stay at the forefront in identifying and addressing the major issues of the day. To do this, we strive to achieve best-in-class work from all areas of the Bank.

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We continued our benchmarking and support of employee-driven resource networks, and we also expanded our efforts to source from small-business and diverse suppliers in our procurements.

■ **Enhancing our resilience and flexibility**

In recent years, we have made major investments to enhance the quality, effectiveness, and efficiency of our internal services—human resources, finance, information technology, and vendor management. We are modernizing many of the Bank’s important information systems to respond flexibly to changing market needs and demands, to speed up our time to market, and to enhance our resilience. We continue to refine the information security protection we provide to the Federal Reserve System and the Treasury to meet the rapidly evolving cybersecurity threat.

■ **Reinforcing our commitment to diversity and inclusion**

We continue our commitment to diversity and inclusion as a business imperative. In 2011, important diversity provisions of the Dodd-Frank Act were implemented. An Office of Minority and Women Inclusion was created at federal financial services agencies, including the Federal Reserve. At the Federal Reserve Bank of New York, we assigned this important responsibility to our pre-existing Office of Diversity and Inclusion. We also strengthened our long-standing pursuit of workforce diversity by adopting a diverse-slate philosophy in our recruitment efforts. We continued our benchmarking and support of employee-driven resource networks, and we also expanded our efforts to source from small-business and diverse suppliers in our procurements. As part of our outreach efforts in 2011, we also hosted two programs—*Access to Opportunity Forum* and *New Fundamentals of Accessing Capital*—that brought together a number of firms to discuss best practices and challenges for small businesses, including women- and minority-owned firms.

■ **Creating opportunities for staff development**

We continuously seek opportunities for staff to learn and grow. We have been extraordinarily fortunate to attract and retain talented staff who have served us with professionalism and dedication through the challenges of the last several years. These challenges have also brought unique opportunities for staff to develop new expertise. We are implementing a number of career mobility efforts to ensure that people have the chance to work in other areas of the Bank—an experience that enables employees to build and refine their skills and to deepen their knowledge of the roles of a central bank.

■ **Promoting efficiency and business process excellence**

We recognize that we must constantly challenge ourselves to increase efficiency and allocate resources to those areas where they can have the most impact in pursuit of our public mission. To that end, we have worked with our colleagues around the Federal Reserve System to reengineer processes and, in some instances, to consolidate processes so as to leverage economies of scale.

We are also achieving efficiency through the pursuit of business process excellence (BPE). In 2011, we made important strides in promoting BPE throughout the Bank. BPE was initially championed by the Financial Services Group, and it has proved to be an important factor in making our operations more efficient and resilient. But beyond these achievements, I believe that continued propagation of BPE principles within the organization will allow us to upgrade staff responsibilities and make employees’ working lives more interesting and richer in development opportunities.

Communications

Making the Bank more transparent

The Bank has continued to evolve to become more and more open with its stakeholders and the public at large. We are working to meet expectations from the public and the markets for transparency, championing best-in-class practices that seek to maximize disclosure consistent with the delivery of our public responsibilities.

During 2011 and into 2012, we made important strides in this direction. The Bank now releases the primary dealer survey—our regular survey of market expectations for the economy and monetary policy. In addition, we now release charters, membership rosters, meeting agendas, and minutes of our advisory committees.

■ Reaching new audiences through our blog and other online platforms

While we are reaching out in person, we are also broadening our engagement with the public and outside experts through new digital and multimedia tools. In 2011, the Bank's Research and Statistics Group launched *Liberty Street Economics*, a blog featuring insights and analysis from economists working on the intersection of research and Fed policymaking. Structured so that it can be shared across a number of platforms, the blog encourages users to comment on posts and pose

questions to the authors. The introduction of the blog and other online enhancements is part of the Bank's broader, ongoing plan to deploy multimedia to reach new audiences and shed greater light on our actions.

■ Talking to our critics

At the same time, we are systematically working to engage with the views of experts who do not agree with our policies or decisions. Bank staff are committed to exploring differences of opinion and challenges to our assumptions. Through the *Listening to Our Critics* internal speaker series, we have welcomed critics, including the noted economists John Taylor and Simon Johnson and the filmmaker Charles Ferguson, to the Bank and engaged in productive discussions with all of them.

An Ongoing Dialogue

In conclusion, we are committed to doing all that we can to best carry out the mandate given to us by Congress. This will always guide our work. To this end, we will continue to intensify our engagements with the full range of stakeholders in the economy who are affected by our policy decisions. I look to all my staff, all of us who work here, to be ambassadors for our institution and the public interest purpose that it serves.

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William C. Dudley
May 10, 2012