Letter from the President

LETTER FROM THE PRESIDENT

The year 2013 marked the centennial of the Federal Reserve System. During the year, the Federal Reserve Bank of New York continued a long tradition of executing its mission in the interest of the public that it serves. In particular, the New York Fed made significant progress in strengthening the financial system, creating new tools and processes to support monetary policy normalization, modernizing the payments system, and conducting high-quality analysis and outreach in areas important to the public.

In this letter, I will highlight some of these initiatives and reflect on our centennial year, offering my thoughts on the challenges that lie ahead for the New York Fed and the System.

Strengthening the Financial System: Capital Planning, Standards, and Reform of the Tri-Party Repo Market

In 2013, we made substantial contributions to the Federal Reserve System's efforts to ensure that the largest, most systemic supervised institutions have robust, forward-looking capital planning processes, sound liquidity risk management practices, and sufficient resolution planning.

Our support for efforts to strengthen the financial system also extended internationally: The Bank contributed to the setting of international standards under Basel III, including the Tier 1 Leverage Ratio and the Net Stable Funding Ratio, and to the Financial Stability Board's work on resolution. The Bank also contributed to the international financial stability agenda through its work on the Committee on the Global Financial System (which I chair) and the Standing Committee on Assessment of Vulnerabilities.

We also worked with market participants to make important progress in reducing the reliance on intraday credit in order to reduce systemic risk in the tri-party repo market. Additional work is needed to ensure that risk management practices in this market are more robust to a broad range of possible events and outcomes.

Policy Normalization: Testing, Operational Readiness, a Counterparty Pilot Program

We made substantial analytical and operational contributions in 2013 that will ultimately support the Federal Reserve in a more normalized monetary policy environment. As part of these efforts, we began testing a fixed-rate, overnight reverse repurchase facility to support the Federal Open Market Committee's (FOMC) longer-run planning for the implementation of monetary policy. The operations are available to a broad range of counterparties, and the facility could help the Fed tighten its control over money market rates.

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In 2013, we also launched a one-year pilot program with small broker-dealers in an effort to examine options for further broadening access to the Federal Reserve's monetary policy operations. The program permits a select number of small firms to participate as counterparties in outright purchases and sales of U.S. Treasury securities for the System Open Market Account portfolios.

Analysis and Outreach: The Survey of Consumer Expectations

As part of the Bank's analysis and research work, we introduced the Survey of Consumer Expectations (SCE). Conducted monthly, the SCE has yielded a wealth of data on U.S. consumers' expectations regarding inflation, home prices, job prospects, and earnings growth, as well as their expectations about future spending and access to credit. Through this type of tool, the Bank is providing the public with unique insight into the perceptions and economic activity of consumers.

Payments: Wholesale Financial Services and the Future of Payments

The Bank also undertook an important modernization of our payment products. In particular, we made substantial contributions to updating the Fedwire Funds Service and the Fedwire Securities Service, and provided key leadership in preparing for the next generation of payment systems in support of the Federal Reserve Financial Services Strategic Plan. Moreover, the Bank completed a successful infrastructure migration to a new operating platform—another step to ensure that our services remain world-class and responsive to the needs of customers, financial markets, policymakers, and the industry into the future.

The Fed's 100th Anniversary, a Time to Reflect and Look Ahead

The year 2013 marked the 100th anniversary of the establishment of the Federal Reserve System, an essential contributor to American economic prosperity and stability. The New York Fed has played an integral role within the System and will continue to do so as we confront the challenges that lie ahead. This anniversary represents an appropriate time to reflect on those challenges and what it will take to address them effectively going forward. The Museum of American Finance hosted "The Fed at 100," an exhibit commemorating the Fed's centennial, and at the opening of that exhibit last September, I posed the following as some of the most salient challenges for the year ahead.

Challenges on a Number of Fronts: Monetary Policy, Regulation, Financial Stability, and Human Capital

The first challenge we foresee is on the monetary policy front. The Federal Reserve has engaged in a set of unconventional monetary policies in recent years. These policies have been necessary because the FOMC could not ease monetary policy further by conventional means; additional reductions in the target range for the federal funds rate were constrained by the so-called "zero lower bound." Exit from this unconventional set of policies is certainly feasible: the ability to pay interest on excess reserves gives us a viable tool to manage monetary policy even with an enlarged balance sheet, and the New York Fed is prepared to execute this mission. However, there will undoubtedly be operational and communications challenges and unexpected consequences. We will need to be sufficiently agile so that we can best achieve our dual mandate of maximum sustainable employment in the context of price stability.

The second challenge for us at the New York Fed, and within the regulatory community more generally, will be in staying the course and implementing a regulatory regime in which no institutions are too big to fail (TBTF). TBTF is wrong for several reasons. It creates an unfair disparity between large and small institutions. In addition to being unfair, it creates greater risks to financial stability by encouraging greater size and complexity. We have made considerable progress toward ending TBTF—raising capital and liquidity requirements for the largest, most systemic banks—but we still have a way to go. In particular, significant barriers to achieving a cross-border resolution remain, and there are still insufficient incentives in place for firms to take corrective action early on to prevent their failure in the first place.

The third challenge for the Federal Reserve is to put financial stability on par with monetary policy. As our experience from 2007 to 2009 has demonstrated, monetary policy cannot work properly when there is financial instability. Financial instability disturbs market functioning and can impair bank balance sheets in a way that disrupts banks' financial intermediation function, constraining the availability of credit for households and businesses. Such outcomes, in turn, can lead to further reductions in aggregate demand, placing additional stress on the weakened financial system. For these reasons, financial stability cannot be subordinated to any other priority.

The fourth challenge is to sustain and enhance the capabilities of the New York Fed. This task requires at the outset that we continue to attract, develop, and retain the best people. But it also requires tending to the culture of the institution—for example, ensuring that good ideas rise to the top no matter where they originate, and that people feel comfortable challenging the conventional wisdom.

Unique Attributes of the New York Fed

I am confident that what makes the New York Fed unique will allow us to play an effective role within the System in facing these, and any new, challenges successfully.

We are a bank within government. That means we not only have researchers, supervisors, and market analysts, but we also provide banking services and possess significant operational capabilities. We accept deposits, make loans, and operate the System Open Market Account for the Federal Open Market Committee. When exigent and unusual circumstances require extraordinary operations, be it in a financial crisis or to implement unconventional monetary policies, our operational capabilities complement our more conventional central bank policy role.

In addition, the New York Fed, as a vital component of the international functions performed by the Federal Reserve System, has a unique understanding of and credibility in the global financial system. This can be seen in our Central Bank International Account Services business line, in our supervisory responsibility over many of the largest foreign banking operations in the United States, and in our active participation in global forums, including the Basel Committee and the Financial Stability Board. This international expertise was very much in evidence during the crisis as we

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negotiated foreign exchange swap agreements with a number of foreign central banks and then operationalized the provision of dollar liquidity worldwide through a coordinated system of dollar auctions.

Perhaps most importantly, we have a remarkably talented and dedicated group of people working at the Bank who are committed to promoting the mission of the institution and serving the public interest. Our staff has proved itself willing to do what is necessary to identify, develop, and execute the right plan of action. While this spirit of dedication was most clearly and publicly evident during the Bank's response to the financial crisis—when we played a key role within the System in preventing a financial panic from turning into a worldwide depression—it informs our work each day and will help us and the System meet the important challenges ahead.

We look forward to continuing to play a critical role in the economic well-being of our nation.

William C. Dudley
June 6, 2014