BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
MANAGEMENT DIVISION

DATE: December 14, 2001

TO: Board of Governors

VIA: Stephen R. Malphrus and Vice Chairman Roger W. Ferguson, Jr.

FROM: Carol A. Sanders, Stephen J. Clark, and William Jones

SUBJECT: 2002–03 Proposed Budget

ACTIONS REQUESTED

Approval of the 2002–03 Board operations, capital, and extraordinary items budgets as itemized below:

1. An operating budget of $455.0 million. This figure represents an operating budget increase of 7.5 percent annually, or $61.6 million for the biennium. The budget includes 1,739 positions, a net increase of 11 positions.[1]

2. A capital budget of $29.9 million (see page 6).

3. An extraordinary items budget of $1.5 million for two statistical survey projects (see page 7).

4. Approval for the Administrative Governor to adjust the operating and capital budgets during 2002–03 to reflect actions required to capitalize certain budgeted software developed or acquired for internal use.

Summary of 2002-03 Budget Requests

	Operations Budget	Extraordinary Items	Office of Inspector General[2]
Proposed Operating Budget	$454,987,756	$1,500,000	$7,756,833
Proposed Capital Budget	$29,851,470	-	$10,000
Requested Positions	1,739	-	29

[1] These figures do not include funding or positions for the Office of Inspector General.
[2] Provided for information only. As an independent office, the Inspector General will submit his budget to the Board separately.

OVERVIEW OF THE BUDGET

Process

On a biennial basis, the Board and its senior staff undertake a process that result in a strategic plan for the next four years and a budget for the next two years. For the 2002–05 planning period and the 2002–03 budget period, the Committee on Board Affairs, assisted by a senior-level Staff Planning Group (SPG) and staff in the Program Analysis and Budget Section of the Management Division, guided the process. Each division director, working with his or her oversight committee, examined the division's operations to see how the mission, organization, and resources needed to be adjusted to enable the Board to carry out its mission more efficiently and effectively. The process readjusted priorities to accomplish the mission, and identified important but lower priority work for elimination in order to fund some of the higher priorities. Subsequently, in August, the Board approved a budget objective to implement those planning decisions and budgets were submitted in early September. The terrorist actions of September 11 resulted in significant revisions to those budget submissions.

Planning

The Staff Planning Group reviewed the planning materials submitted by the Board's divisions and offices and identified major issues as having Boardwide impact over the planning period. These issues are reflected in the resource decisions of the Committee on Board Affairs that form the basis of the proposed budget. They will also serve as the basis for the 2002-03 Performance Plan prepared as part of the Board's voluntary compliance with the Government Performance and Results Act. Major issues include:

- *Management and staffing*: Recruiting and retaining staff were once again raised as issues of significant concern in a number of divisions. Also, in response to a significant number of senior staff eligible for retirement, management succession planning and organizational structure is a top priority.
- *Board organization*: A comprehensive review of Reserve Bank oversight activities, including a reexamination of the legal requirements for oversight, could result in a more efficient, effective, and consistent approach.
- *Information technology*: In line with planning guidance, divisions re-examined their information technology spending to ensure that high-priority items are fully funded while lower-priority items are either reduced or eliminated. Doing so held information technology spending at current levels.
- *Physical plant*: Purchase of a new building will significantly lower office space costs.
- *External and internal factors*: The work of the Board will continue to be affected by environmental factors over which the Board has little or no control. The Board and its staff must stand ready to adjust priorities as necessary to deal with economic events, often unforeseen and rapidly developing, and their effects on monetary, supervisory, and regulatory policymaking.

Major Initiatives

To address these major planning issues, the proposed budget includes the following major initiatives and projects for the 2002–03 period listed below. Additional division-specific initiatives and project discussions may be found in the appendix beginning on page 12.

- *Attraction and retention of staff*: Initiatives to improve the Board's ability to attract and retain staff include the variable pay program for economists, attorneys, and officers; an increase in the employee cash award program; a 4.6 merit increase for 2002; and an estimated 4.0 percent for the 2003 merit increase.
- *Employee benefits*: A major increase in health insurance rates is funded as well as initiatives to increase the transportation subsidy, increase the Board match in the Thrift Plan, and to fund costs associated with the revised leave policy.
- *Workload*: Increased staffing and a reduction in the number of vacant positions in specific divisions in response to increased workloads, new security concerns, and a fewer position vacancies following implementation of the compensation initiatives will all affect salary liability.
- *Information technology (IT)*: Funding reflects significant reallocations of information technology resources by the various divisions among projects after a comprehensive review of requirements and priorities. Central IT support was funded at the current level except for increases to enhance disaster recovery.
- *Physical Plant*: In line with the Board's earlier strategic plan, a new building purchased earlier this year will significantly reduce operating costs for office space. Capital investments are planned for the three Board facilities as discussed in the capital section below. Additional noncapital improvements are also planned at all three facilities as outlined in the Management Division discussion on page 15.

Ramifications of the September Terrorist Attacks

After the terrorist attacks on September 11, the projects and initiatives listed below were added to the 2002–03 budget proposal. The list also includes, where known, programmatic changes required long term for the appropriate handling of a changed working and economic environment. These items and their associated operating costs of $13.8 million are included in the total proposed budget as outlined on the first page of this memo and in the attached tables.

- Enhanced capacity Boardwide for disaster recovery to reduce the time for resuming normal operations at remote sites and to increase the amount of information and the number of systems supported at those sites
- Initiatives to enhance physical security, including adding security staff; using bomb-sniffing dogs for greater perimeter security; and using contract support for mail processing; and other, less visible, measures
- Additional staff in the Division of Reserve Bank Operations and Payment Systems to focus on system security issues in response to new terrorism-related legislation, and a new section (including new staff) to focus on private-sector clearance and settlement systems to increase the Board's understanding and competence in this area

- Two positions in Banking Supervision and Regulation to focus on money laundering and financial transactions associated with terrorist activity in response to new terrorism-related legislation
- Four positions in the Office of the Staff Director for Management to improve the planning and coordination of contingency operations, and to act as a liaison with the new Office of Homeland Security.

Areas of Risk

Despite our best planning efforts, we recognize the possibility that further developments could require significant resources beyond the current proposals. These developments could include the following:

- Significant changes in or shocks to the economy and/or financial system
- Additional terrorist or war activity resulting in more security and contingency requirements
- Determination that Systemwide supervisory technology initiatives should be funded and managed by the Board (see page14)
- Changes to the position vacancy rate assumptions used in developing the salary budget and the resulting building requirements should a change in staffing patterns occur.

OPERATIONS BUDGET BY DIVISION AND ACCOUNT CLASSIFICATION

The Board's overall operations budget is detailed by division in table I and by account classification in table II. The largest increase in the 2002–03 budget is in personnel services. The proposed budget for personnel services (salaries, retirement, and insurance) is $338.1 million greater than the 2000–01 base (an average increase of 8.4 percent per year). The addition of eleven positions explains a portion of this increased budget. Merit pay, new compensation initiatives, promotions and reclassifications, higher benefit costs, and a lower lapse rate in certain divisions are also increasing the budget requirements.

The 2002–03 budget for goods and services is $116.8 million, which is $11.1 million greater than the 2000–01 base (an increase of 5.1 percent per year). Much of this increase is attributable to computer hardware, software, and contractor support for additional disaster recovery work and security-related contractors and support, all stemming from the September 11 attacks.

Partially offsetting these increases are programmatic reductions in areas throughout the Board. These include significant changes in various accounts due to the transition from leasing office space to owning the building, with an overall reduction in expenses of $3.0 million annually. Additionally, the replacement cycle for desktop computers will be extended, and support for regular information technology projects has been considerably scaled back after various divisions changed priorities and eliminated low-priority projects.

OPERATIONS BUDGET BY OPERATIONAL AREA

The Board's operations budget supports four broadly defined operational areas: monetary and economic policy, supervision and regulation, services to financial institutions and the public, and System policy direction and oversight. A summary discussion of the resources budgeted for each area for 2002–03 is provided.

The largest increase in expenses is in the security portions (both information and physical) of overhead, which is spread, in proportion to direct expenses, among the four operational areas (see below). This increase does not directly enhance the efficiency or effectiveness of current Board operations, but it is necessary given recent changes in the threat environment facing the nation and the Board.

Monetary and Economic Policy

The 2002–03 budget for monetary and economic policy is $182.5 million, an increase of $19.2 million, or an average of 5.7 percent per year. Besides the additional funding for compensation initiatives, programmatic increases in this area are for the acquisition of additional data to assist staff in their responsibilities. These data relate to capital risk, retail banking fees and services, global financial markets, and consumer credit.

Supervision and Regulation

The 2002–03 budget for supervision and regulation is $186.7 million, an increase of $27.9 million, or an average of 8.4 percent per year.

With this budget, expenses for the supervision and regulation function at the Board exceed those of the monetary policy function. Programmatic increases include greater focus on money laundering activities, international training and assistance to foreign governments, and a review of regulations and policies related to consumer protection. As risks to the financial sector grow with the continuation of the economic downturn, the staff will need to spend more time on bank examinations and monitoring as appropriate under the risk-based supervision model implemented over the past few years.

Services to Financial Institutions and the Public

The 2002–03 budget for oversight of Reserve Bank services to financial institutions and the public is $9.0 million, a decrease of $0.1 million, or an average of 0.7 percent per year. Costs associated with these programs will decline slightly during the next biennium because of the realization of savings from previous initiatives.

System Policy Direction and Oversight

The 2002–03 budget for System policy direction and oversight is $76.8 million, an increase of $14.5 million, or an average of 11.0 percent per year.

Major programmatic changes in this area include greater focus on security and contingency planning Systemwide and a new section to provide staff expertise on private-sector clearance and settlement systems. Less lapse and an enhanced communication program are also responsible for the substantial increase.

CAPITAL BUDGET

The Board's proposed 2002–03 capital budget is $29.9 million (see table III). Of this total, $19.8 million supports continued improvements in office automation and major upgrades to the information infrastructure, including completion of the Martin recabling project, centralization and improvement of distributed systems disk storage, and scheduled server replacements in the data center. Funds are also provided for the maintenance and upkeep of the Eccles/Martin complex, including security system upgrades planned before the events of September 11, elevator refurbishment, equipment replacement, interior restoration on the concourse and terrace, and Eccles courtyard restoration upon completion of the Eccles Building Infrastructure Enhancement Project (EBIEP). Major facility projects include the purchase of an emergency generator, replacement of the Eccles building roof, upgrades to security at the building entrances, and a design/feasibility study for a major renovation of the Martin Building.

Another, $3.3 million is for projects resulting from the September terrorist attacks, including substantial improvements to our information disaster recovery systems and expansion of the scope of the building entrance security upgrade project already scheduled.

Completion of the EBIEP is $3.5 million. This amount is $8.3 million less than the 2000–01 base because of the phased nature of the project, which began in July 1999. The project, which consists of replacing the voice and data cabling plant, replacing piping, and making other, related repairs, extends the building's useful life and improves the fire safety systems. This project is scheduled for completion in early 2003.

The remaining $3.3 million is for projects associated with the new building. These improvements, which were identified during the due diligence period of the purchase negotiations, include improving building security; correcting code compliance issues; repairing the garage; installing an emergency generator; upgrading electrical, HVAC, and control systems; and replacing carpets.

POSITIONS

Because of responses necessitated by the September terrorist attacks, a net of eleven positions has been added to the Board's authorization; the proposed total is 1,739 positions (see table IV).

The original budget request was to include a net reduction of eight positions after a very thorough planning review. A net increase of four positions was authorized for the Division of Consumer and Community Affairs to eliminate four long-term dual occupancies. One position was added to the Division of Reserve Bank Operations and Payment Systems and three positions to the Management Division in response to workload issues. Small, offsetting position reductions were made in many divisions where efficiencies and workload factors made such decreases possible.

After September 11, nineteen positions were added. These positions are necessary to: increase the Board's physical security (7), ensure compliance with new police powers provided to System security staff under new legislation (2), provide additional resources for antiterrorism and anti-money laundering activities (2), and increase the Board's expertise in private-sector clearing and settlement systems (8).

EXTRAORDINARY ITEMS

The Board's extraordinary items budget for 2002-03 provides required funding for two surveys: the Survey of Small Business Finances ($0.8 million), and the Survey of Consumer Finances ($0.7 million). These surveys will improve the quality of economic data produced by the Board by gathering information on the economic behavior of U.S. households and the financial health of U.S. firms (see page 19 for more information).

Operating Budget
by Division, Office, and Special Account

Table I

Division	2000-01 Base	2002-03 Budget Request	Difference	Annual Percent Change
Office of Board Members	$ 8,524,471	$ 11,813,149	$ 3,288,678	17.7%
Office of the Secretary	8,959,199	11,255,557	2,296,358	12.1%
Office of Staff Director for Management	3,935,163	7,096,807	3,161,644	34.3%
Division of Research & Statistics	62,741,284	67,381,597	4,640,313	3.6%
Division of International Finance	22,706,059	24,872,960	2,166,901	4.7%
Division of Monetary Affairs	18,835,301	19,665,928	830,627	2.2%
Division of Banking Supervision and Regulation	62,840,157	73,859,170	11,019,013	8.4%
Division of Consumer and Community Affairs	18,094,356	20,670,649	2,576,293	6.9%
Legal Division	18,148,072	20,754,001	2,605,929	6.9%
Division of Reserve Bank Operations & Payment Systems	30,994,943	35,547,609	4,552,666	7.1%
Division of Support Services	59,289,133	63,684,188	4,395,055	3.6%
Division of Information Technology	76,040,908	81,854,974	5,814,066	3.8%
Management Division	22,317,690	25,248,294	2,930,604	6.4%
IRM Income	(38,967,883)	(41,477,071)	(2,509,188)	3.2%
Residual Retirement and Insurance Benefits	7,806,621	8,166,400	359,779	2.3%
Special Projects	12,676,768	21,906,544	9,229,776	31.5%
Savings and Reallocation	(5,483,873)	(1,000,000)	4,483,873	-57.3%
Publications Committee	3,934,461	3,687,000	(247,461)	-3.2%
Total Board	**$ 393,392,830**	**$ 454,987,756**	**$ 61,594,926**	**7.5%**
Change for Estimated Software Capitalization	-	(2,200,000)	(2,200,000)	…
Revised Board Total	$ 393,392,830	$ 452,787,756	$ 59,394,926	7.3%
Extraordinary Items	$ 8,597,673	$ 1,500,000	$ (7,097,673)	…
Inspector General	$ 6,617,406	$ 7,756,833	$ 1,139,427	8.3%

Operating Budget
by Account Classification

Table II

Division	2000-01 Base	2002-03 Budget Request	Difference	Annual Percent Change
Personnel services				
Salaries	$ 245,030,625	$ 287,097,441	$ 42,066,816	8.2%
Retirement	22,897,461	27,420,680	4,523,219	9.4%
Insurance	19,725,164	23,631,128	3,905,964	9.5%
Subtotal	$ 287,653,250	$ 338,149,249	$ 50,495,999	8.4%
Goods and services				
Travel	$ 12,235,132	$ 13,606,069	$ 1,370,937	5.5%
Postage and Expressage	1,575,758	1,606,500	30,742	1.0%
Telecommunications	7,046,018	7,798,400	752,382	5.2%
Printing and Binding	2,549,000	2,543,000	(6,000)	-0.1%
Publications	2,296,301	2,066,300	(230,001)	-5.1%
Stationery and Supplies	2,004,835	2,403,671	398,836	9.5%
Software	9,914,982	11,222,706	1,307,724	6.4%
Furniture and Equipment	8,099,840	7,000,315	(1,099,525)	-7.0%
Rentals	10,273,735	857,466	(9,416,269)	-71.1%
Books and Subscriptions	2,087,314	2,120,424	33,110	0.8%
Utilities	4,516,900	5,555,000	1,038,100	10.9%
Building repairs and alterations	3,479,482	3,688,000	208,518	3.0%
Furniture repairs and maintenance	4,277,691	7,124,161	2,846,470	29.1%
IRM Expense/R&S-MA	1,939,462	1,527,760	(411,702)	-11.2%
IRM Income/R&S-MA	(1,939,462)	(1,527,760)	411,702	-11.2%
Contingency processing center expenses	400,000	400,000	-	0.0%
Contractual professional services	28,537,540	32,383,544	3,846,004	6.5%
Interest Expense	101,781	80,000	(21,781)	-11.3%
Tuition/registration and membership fees	3,213,538	3,172,877	(40,661)	-0.6%
Subsidies and Contributions	1,865,700	1,896,744	31,044	0.8%
All Other	3,143,936	4,446,940	1,303,004	18.9%
Savings an Reallocation	(4,749,857)	(1,000,000)	3,749,857	-54.1%
Depreciation	17,419,668	25,482,377	8,062,709	20.9%
Income	(14,187,874)	(17,673,947)	(3,486,073)	11.6%
IRM User Charge	38,337,972	41,432,534	3,094,562	4.0%
Net Cafeteria	(154,350)	-	154,350	-100.0%
Gain/Loss	266,885	102,500	(164,385)	-38.0%
IRM Income	(38,812,347)	(41,477,074)	(2,664,727)	3.4%
Subtotal	$ 105,739,580	$ 116,838,507	$ 11,098,927	5.1%
Total Board	**$ 393,392,830**	**$ 454,987,756**	**$ 61,594,926**	**7.5%**
Change for Estimated Software Capitalization	-	(2,200,000)	(2,200,000)	…
Revised Board Total	$ 393,392,830	$ 452,787,756	$ 59,394,926	7.3%
Extraordinary Items	$ 8,597,673	$ 1,500,000	(7,097,673)	…
Office of Inspector General	$ 6,617,406	$ 7,756,833	1,139,427	8.3%

Capital Budget **Table III**
by Division, Office, and Special Account

Division	2000-01 Base	2002-03 Budget Request	Difference
Office of Board Members	$ -	$ -	$ -
Office of the Secretary	566,825	95,000	(471,825)
Office of Staff Director for Management	-	210,000	210,000
Division of Research & Statistics	777,500	450,000	(327,500)
Division of International Finance	192,000	50,000	(142,000)
Division of Monetary Affairs	-	150,000	150,000
Division of Banking Supervision and Regulation	2,100,492	-	(2,100,492)
Division of Consumer and Community Affairs	237,600	-	(237,600)
Legal Division	200,000	-	(200,000)
Division of Reserve Bank Operations & Payment Systems	-	10,000	10,000
Division of Support Services	16,507,737	17,824,470	1,316,733
Division of Information Technology	6,568,000	7,954,000	1,386,000
Management Division	286,236	3,108,000	2,821,764
IRM Income	-	-	-
Residual Retirement and Insurance Benefits	-	-	-
Special Projects	1,850,764	-	(1,850,764)
Savings and Reallocation	-	-	-
Publications Committee	-	-	-
Total Board	**$ 29,287,154**	**$ 29,851,470**	**$ 564,316**
Change for Estimated Software Capitalization	-	3,200,000	3,200,000
Revised Board Total	$ 29,287,154	$ 33,051,470	$ 3,764,316
Extraordinary Items	$ -	$ -	$ -
Inspector General	$ 10,000	$ 10,000	$ -

Position Summary **Table IV**
by Division, Office, and Special Account

Division	2000-01 Authorization	2002-03 Proposed	Difference
Office of Board Members	43	42	(1)
Office of the Secretary	56	56	-
Office of Staff Director for Management	15	19	4
Division of Research & Statistics	279	278	(1)
Division of International Finance	119	119	-
Division of Monetary Affairs	60	59	(1)
Division of Banking Supervision & Regulation	227	222	(5)
Division of Consumer & Community Affairs	78	82	4
Legal Division	82	82	-
Division of Reserve Bank Operations & Payment Systems	127	138	11
Division of Support Services	212	215	3
Division of Information Technology	304	305	1
Management Division	124	121	(3)
Special Projects	2	1	(1)
Total Board	**1,728**	**1,739**	**11**
Inspector General	29	29	-

APPENDIX – SUPPLEMENTAL INFORMATION

Planning and Budgeting Process

The Board's budget covers a two-year period. The first year of the budget cycle--the even-numbered year--is used to update the strategic plan for the next four years, and the second year is used to develop the budget for the next two years.

The two-year cycle begins in the fall (thus, for the 2002-03 budget, the fall of 2000). At that time, the Board's divisions examine their operating environments and look for any adjustments to their mission, priorities, activities, and associated resources that might improve the efficiency and effectiveness of the Board's operations.

The management of each division discusses with the appropriate Board oversight committee the issues that result from its review. After any adjustment, the results are given to the Staff Planning Group, a small group of senior managers with a Boardwide perspective, for use in their analysis of the Board's budget options.

After consulting with the Board-level Committee on Board Affairs for final guidance, the Staff Planning Group updates the strategic plan, which is used to prepare a preliminary budget objective that identifies the level and allocation of resources needed to support the plan. As part of this process, individual division budget objectives are prepared on the basis of Boardwide priorities and planning assumptions. The Committee on Board Affairs reviews the plan and preliminary budget objective, clarifies outstanding planning issues with the Staff Planning Group and division directors and, at the end of summer of odd-numbered years, submits the budget objective to the Board for its consideration. The divisions use the budget objective approved by the Board to complete their budgeting under the approved plan.

This process was almost complete on September 11, when the attacks changed the landscape in which we operate. Therefore, divisions were asked to reexamine their programmatic goals and resource requirements for 2002–03. Several changes have been made as discussed on page 3, and the final budget proposed in this memo includes these changes. The discussions below focus on the normal responsibilities and operations of the divisions.

Operations Budget by Division

Key projects and initiatives associated with each divisional budget are discussed below.

<u>Office of Board Members</u>

The office will continue to concentrate on the Public Affairs area during the 2002–03 biennium, including a new focus on increasing the use of information technology to improve productivity and to provide materials to the press and the public. The office now houses Publications Services (transferred from the Division of Support Services) and the FOMC Secretariat (transferred from the Division of Monetary Affairs). Most of the increase in the budget this biennium is the result of these additional programs, as well as the vacant Governor positions that were recently filled.

Office of the Secretary

The office will continue its focus on the use of electronic information technology to enhance the performance of many of its responsibilities. Major elements of this focus during 2002-03 include the Board's Records initiative to prepare for a substantial increase in the information that is transmitted to the Board and used by the staff on-line without conversion to paper. An applications programming interface will enable the Federal Reserve Integrated Records Management Architecture to receive records electronically from large-scale, Systemwide applications, including the Central Document Text Repository, the Applications Management and Processing System, and Planning and Analysis Tool. The office also plans to improve the electronic information systems that distribute materials requiring consideration or action to Board members. The office will implement new technical initiatives to facilitate paperless correspondence with the public, including enhancements to the web sites that solicit comments on proposed regulations and applications.

Office of the Staff Director for Management

The office will implement plans to oversee the Board's operations. Key areas of focus include programs to improve management of resources, EEO activities, and contingency planning. The addition of the Protective Services Unit (PSU) to the office in the current budget period, as well as significant staff increases for the PSU, are responsible for the large budget increase for the office.

Division of Research and Statistics

The division will focus on three initiatives dealing with the purchase and collection of data to achieve its mission more efficiently. First, the division plans to move ahead with work on the Basel Reform. The evolution and implementation of the Accord will involve ongoing research on credit risk measurement and the monitoring of changing industry practices, as well as additional basic research pertinent to validating risk measures reported by individual banks and the provision of benchmarks for internal ratings-based capital models. Second, the division will collect information on retail banking fees and services and on bank prices and services. The data on banking fees and services will be reported annually to the Congress as required by law. Finally, the division will seek to obtain more comprehensive credit bureau data than have so far been available. These data will be used to analyze consumer and mortgage debt growth, debt service burdens, delinquency and bankruptcy rates, and credit demand and supply issues.

Division of International Finance

The major challenge for the division in 2002-03 will be responding to the changing global economic environment. This environment will affect the division's mission, functions and workload. The division must monitor and analyze ongoing changes in the world economy and in global financial markets. The demands on staff resources in the area of current analysis will remain high. There is some concern that this will result in insufficient resource allocation toward professional staff development and research projects. The division is optimistic that the recent compensation initiatives will improve their efforts at recruiting and retaining economists, especially in the finance area.

Division of Monetary Affairs

The primary mission of the Division of Monetary Affairs is to provide the Board and FOMC with timely and accurate information and analysis pertaining to the conduct of monetary policy. The division faces three primary challenges in the coming biennium: managing the transition that will occur with the expected retirement of senior management; organizing our records in an electronic format to codify the collective experience of the staff over the past few decades; and increasing the diversity of division staff, especially in the senior ranks.

Division of Banking Supervision and Regulation

During the 2002–03 biennium, the division will work on refining its risk-focused supervision approach, particularly for large complex banking organizations; developing the Board’s role as umbrella supervisor of financial holding companies; increasing the use of information technology to improve supervisory information flow, analysis, and collaboration; continuing active involvement in the Basel Committee on Banking Supervision; providing technical support to foreign governments; and strengthening staff expertise and skill levels. The division is employing its risk-focused approach to respond to the recent deterioration in credit quality and in overall banking conditions and the continued weakness in the economy. This approach requires frequent examinations with expanded scope and in-depth analysis in times of weakened banking conditions. This increased focus is placing a strain on the division. Additional demands will also be placed on division staff to implement the provisions of the USA PATRIOT Act and the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001, as well as other special projects arising from the terrorist attacks of September 11.

The Division of Banking Supervision and Regulation may also bring forward information technology initiatives for the supervision function as a whole during the biennium. The intention is to fund these Systemwide supervision initiatives through reductions in duplicate systems or through improvements in productivity as a result of a better use of resources. Under the supervision function's Strategic Plan Steering Committee (SPSC) and the SPSC IT subcommittee, three areas of IT-related enhancements are being considered: a Systemwide Electronic Document Management Initiative, a Systemwide Examination Scheduling and Resource Management application, and a modernization of the IT support for the Shared National Credit Program.

Division of Consumer and Community Affairs

During the 2002–03 biennium, the division will focus on the continued implementation of the Gramm-Leach-Bliley Act; initiatives to address predatory lending practices that target vulnerable consumers; enforcement of new financial privacy rules; changes in the examiner training program; and consumer education initiatives. Comprehensive reviews of regulations B (Equal Credit Opportunity), DD (Truth in Savings), and BB (Community Reinvestment) and proposed revisions to consumer regulations to accommodate electronic disclosures also are on the division’s agenda. Demands on Community Affairs staff for services and technical assistance remain high. To handle an increasing number of complaints from consumers about banking practices, the division will review the complaint workflow process to identify technology-based productivity enhancements.

Legal Division

The division faces an increasing workload regarding both internal and external issues. During the 2002-03 biennium, efforts will focus on continued implementation of the Gramm-Leach-Bliley Act and related statutory and regulatory changes with staff from both BS&R and DCCA; review of the Community Reinvestment Act and related statutes with staff from DCCA; increased international relationships and issues including supervisory information sharing, bilateral and multilateral swap and credit facilities, and trade agreements; redesign of the discount window and open market activities necessitated by a possible reduction in available government securities; enforcement litigation; and EEO and human resource management issues Boardwide.

Division of Reserve Bank Operations and Payment Systems

The division's budget reflects a strategy to focus on three broad mission areas: Reserve Bank oversight; policy and regulation development; and payments research. To achieve these missions, the division will continue to develop sound, effective policies and regulations to foster payment system integrity, efficiency, and accessibility; produce high-quality assessments of Federal Reserve System operations to assist System management to strengthen internal controls; and conduct research and analysis to enhance policy development and promote the understanding of payment system dynamics and risk.

Division of Information Technology

The division's key goals include supporting the rapidly changing business environments of its customers by implementing appropriate new technologies, improving the Board's technology infrastructure, and continuing to be more responsive, efficient, and productive. Key performance indicators include achieving IT strategic goals and objectives, satisfying customers' needs, performing at a high quality level, and managing risks. Risk management is a newly stated specific indicator, regarding which the division will focus on minimizing reputational and other risks to the Board through improved software and management practices. The division has already designated quality assurance analysts who document, test, and certify IT processes. This program will be expanded to include support staff who use purchased software. The division has identified banking modernization, disaster prevention and recovery, and increased communication with the public as being among the major drivers that will determine the Board's and System's IT needs during the budget cycle. The division will work closely with its customers to adjust priorities to reallocate funds for new service requests as they arise.

Management Division[3]

The division's budget is driven by the need to deliver management services that satisfy the Board's high standards. The division will continue its efforts to revise policies to simplify management actions. It will also support divisions' efforts to attract and retain high-quality staff for the Board. Adjustments to the budget include funding for salary and employee attitude surveys, staff support for the new travel software system, a position for a division director, and increased training.

[3] The Management and Support Services Divisions have recently been combined by Board action and are discussed as one entity in this section. The budget numbers shown in the various tables and discussions in other sections of this memo still refer to the two divisions as separate entities.

The most significant change in the Support Services function is the operation of the newly acquired office building. The division will begin the biennium by ensuring that facilities operations meet the standards used to operate the Eccles/Martin complex, including security, engineering, and maintenance services, and that the budgeted $6.0 million in savings from the purchase are realized in this biennium. The division will also focus on the completion of the Eccles Building Infrastructure Enhancement Project (EBIEP) and the Emergency Generator project for the Eccles/Martin complex. Major, noncapital projects planned for the 2002–03 biennium include refurbishment of the Martin cooling towers and chillers, replacement of various heat exchangers, replacement of the Martin garage lighting, phase 2 of the Eccles exterior marble restoration work, refurbishment of Eccles interior marble walls and floors, and numerous other smaller projects.

<u>Publications Committee</u>

After a comprehensive review of all Board publications, the committee has significantly adjusted its operations. Distribution of materials is increasingly taking place electronically, primarily via PubWeb and the Board's electronic publication subscription service. Therefore, reduced print runs are planned for consumer brochures and the *FRB Bulletin*. Outside printing services have also been reduced.

<u>Special Projects</u>

This budget, administered by the Management Division, provides funds for projects that do not appropriately fall within the realm of the Board's divisions or other special accounts. In 2002-03, varied projects are funded for Board operations in this budget such as three salary-related, performance-based initiatives relating to the cash award and variable pay programs; the employee relocation program; and transportation subsidy. Other items included in this budget are the Reserve Bank audits, the Enhanced Foreign Economic Analysis program, the Board's Van Pool program, the Board's share of the Federal Financial Institutions Examination Council expenses, and multi-division Information Technology Call Report projects.

Operations Budget by Account Classification

A brief discussion of each account classification with major changes between budget periods follows:

<u>Travel (5.5 percent annual increase)</u>

The overall travel budget in increasing because of costs associated with the new Systemwide relocation policy. Without the estimated $1.0 million required to implement this policy change, and an additional $0.7 million due to the continuation of a higher number of relocations than past norms, the travel budget would decrease by $0.3 million. Travel, exclusive of relocation, by staff in the monetary and economic policy and supervision and regulation areas are increasing slightly overall during the next biennium, primarily driven by an increase in the amount of foreign travel to keep abreast of the increasingly global financial network. These increases are more than offset by reductions in travel by staff in the system oversight area under the restructured oversight program and in the support and overhead areas due to cost-containment measures and a reassessment of priorities.

<u>Telecommunications (5.2 percent annual increase)</u>

This increase reflects a requirement for more voice/data circuits in Board operations. As a greater amount of the Board's work is handled with more and more complex technology, the amount of data being transmitted is significantly increasing. More robust contingency requirements also necessitate more circuits, to keep the remote sites current with the various data flows, as well as an enhanced wireless voice communication system.

<u>Publications (5.1 percent annual decrease)</u>

After a comprehensive review of the publications program, the number of hard-copy publications is projected to be significantly reduced as more publications are being distributed electronically. Specifically, funding for consumer brochures will decrease by $0.2 million, the *FRB Bulletin* by $0.1 million, and outside printing services by $0.4 million.

<u>Stationery and Supplies (9.5 percent annual increase)</u>

Consumable supplies for the new pathogen-detection equipment being used to screen all incoming mail are causing expenses in this account classification to increase dramatically. Without the estimated $0.25 million for testing supplies required during the biennium, expenses in this category for normal office supplies are increasing at an annual rate of 2.4 percent.

<u>Software (6.4 percent annual increase)</u>

Additional software licenses and maintenance fees required for the more robust contingency operation plans are estimated at $0.6 million for the biennium. Without these costs, expenses in this classification are increasing only at an annual rate of 3.5 percent. Software purchases by the various divisions are decreasing by $0.2 million, while software purchases by the Division of Information Technology are increasing by $0.4 million for vendor price increases, and new initiatives such as next generation firewall and web technology.

<u>Furniture and Equipment (7.0 percent annual decrease)</u>

In an effort to control costs with minimal operational effects, the Board will extend the replacement cycle for personal computers from three years to four, resulting in savings of $1.4 million during the biennium. Slightly offsetting this decrease are purchases for the expanded contingency operations of $0.3 million.

<u>Rentals (71.1 percent annual decrease)</u>

With the purchase of the new building, the Board expects to realize $3.0 million in net annual savings. The largest, single component of those savings is the elimination of lease payments of $5.0 million per year, offset by depreciation, and other operating expenses.

<u>Utilities (10.9 percent annual increase)</u>

As the owner of the new building, the Board must now pay for utility costs, estimated at $0.84 million for the biennium, explaining most of the increase in this classification. For the Martin/Eccles complex, utility costs are estimated to remain flat with the exception of steam costs due to an anticipated price increase by the General Services Administration, which supplies the Board's steam.

Repairs and Maintenance (29.1 percent annual increase)

This significant increase reflects planned new initiatives such as storage architecture and next generation firewall maintenance in addition to ongoing infrastructure support costs in the Division of Information Technology.

Contractual Professional Services (6.5 percent annual increase)

Prior to additions related to the September 11 attacks, expenses in this classification were anticipated to decrease by 1.8 percent per year. Increases in expenses associated with obtaining additional data sets in the research divisions, new EEO and HR initiatives, and fee increases in the supervisory training program are more than offset by a significant reduction in the amount of contractor support in the Division of Information Technology resulting from their reprioritization of projects. Expenses tied to post-September 11 items support additional armed and unarmed guards, bomb-sniffing dogs, contractor support for processing incoming mail, and contractor assistance in enhancing contingency operations capacity.

All Other (18.9 percent annual increase)

The largest increase in this classification is a $0.86 million increase in transit subsidy payments, partly due to annualizing changes made during 2000–01 and partly due to raising the subsidy limit from $65 to $100 per person per month beginning in January 2002 to encourage the use of mass transportation.

Other, smaller changes include another increase anticipated in Administrative Law Judge fees as our share of the program's caseload growth relative to the other partners in the agreement, and reimbursable conference expenses for the biennial research conference in the Division of Consumer and Community Affairs (the offsetting income is anticipated in the income classification).

Depreciation (20.9 percent annual increase)

This substantial increase is primarily the result of the addition to the Board's asset base of the new building ($3.5 million). Other significant increases include additional depreciation for the Eccles Building Infrastructure Enhancement Project as additional phases are completed ($1.1 million), depreciation of three software packages (Phase 1 of BOND, CARES, and FIRMA) ($2.2 million), and depreciation of equipment for contingency operations ($0.9 million).

Income (11.6 percent annual increase)

Most of the increase in income is due to tenant leases at the new building. This income ($3.86 million) is a significant component of the annual $3.0 million in savings that the acquisition of the building generated. Other increases include income from additional processing of HMDA loan and section 508 processing. Offsetting a portion of these increases is the elimination of resource shared income from the Reserve Banks for NIC following the policy change in 2001 to eliminate the resource sharing program.

Extraordinary Items

The Board's extraordinary items budget for 2002-03 provides funds of $1.5 million for the Survey of Small Business Finances ($0.8 million) and the Survey of Consumer Finances ($0.7 million). These surveys will improve the quality of economic data produced by the Board by gathering information on the economic behavior of U.S. households and the financial health of U.S. firms. Data collection for the 2001 Survey of Consumer Finances will be completed at the beginning of December 2001, and data processing will accelerate in 2002. Preliminary data are expected to be available earlier, but final data will not be completed until 2002. A summary article on the survey will be published in the January 2003 *Federal Reserve Bulletin,* and a version of the survey data will be released to the public shortly thereafter. Preparations for the 2004 SCF are expected to be under way no later than the first quarter of 2003. The survey instrument will be reprogrammed, requiring the generation of highly detailed specifications and the development of a new data management protocol. The last half of 2003 will see increasingly intensive testing of the instrument, development of materials to support data collection, preliminary sample design work, and a full pretest of operations. The staff expects to start interviewing for the 2004 survey in spring 2003.

Work on the Survey of Small Business Finances (SSBF) during the second half of 2002 will involve canvassing Board staff, academics, and other researchers to help determine the content of the 2003 survey. By the first quarter of 2003 at the latest, survey staff will write a memorandum for the Board with recommendations regarding the 2003 survey. Survey staff will also develop a statement of work with a request for proposal expected to be issued around May or June 2003. Following the evaluation of proposals, a contract will be awarded during the fourth quarter of 2003. Work should begin in the fourth quarter of 2003, and fieldwork (which is the portion of the contract with the largest expenditures) will not begin until about April 2004.