Letter from the President

I am pleased to share this report on the Bank's 2009 activities and, with this letter, provide a perspective on the economy, Federal Reserve activities, and the financial crisis of the last few years.

Economic difficulties persisted through 2009. Despite significant improvement in financial conditions, the recovery in the real economy proceeded slowly — with the declines of the first half of the year turning to growth in the third and fourth quarters. Unemployment remained unacceptably high. At 9 percent in November, the unemployment rate in New England was at the highest level in 33 years — although still below the national rate.

At year end, the economy still faced significant challenges. First, while the banking crisis had passed, banking problems remained in many parts of the country and constrained the supply of credit. Second, consumers and businesses remained cautious, with housing prices well below their peak, high unemployment rates, and continued home foreclosures. A third challenge involved the fact that severe recessions have broader ramifications for labor markets — for example, some workers who are unemployed for long periods may suffer a permanent deterioration in their skill sets.

Still, the financial system and economy were in far better shape as 2009 ended than at the beginning of the year. Some of this was due to Federal Reserve actions. Measures like our program to purchase mortgage-backed securities contributed to lower mortgage rates, making it more affordable for households to obtain or refinance a mortgage. Our AMLF lending facility supported money market mutual funds at a time of stress and, ultimately, shored up the market for commercial paper — a market that funds credit cards, student loans, and

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home equity loans. Our Term Asset-Backed Securities Loan Facility (TALF) facilitated the renewed issuance of consumer and small-business asset-backed securities — essentially providing a financing vehicle for credit instruments that had been disrupted by poor functioning in securitization markets. In doing this, we helped make credit more available for student loans, consumer credit, commercial real estate, and small business loans.

Although we are distressed by the financial and economic difficulties that many New Englanders continue to face, we are confident that the steps we took to address the crisis helped avoid much worse outcomes, and we know that our work is not yet done. Some of our notable activities at the Boston Fed in 2009 included operating the AMLF lending facility on behalf of the Federal Reserve System, taking a critical role in the so-called "stress tests" of major banks, and influencing foreclosures and policymaking with workshops for troubled borrowers in Hartford and Boston and with insightful research. We have also tried to contribute to the revitalization of the city of Springfield, Massachusetts, with research and with meetings with local stakeholders around the issue of fostering more collaborative leadership. We have developed innovative payment and accounting services that assist the U.S. Treasury Department and, ultimately, taxpayers. Also, as discussed in last year's annual report, we have an ongoing interest in New England's future skilled labor force and retaining recent college graduates. Building on that work, this year we partnered with the Greater Boston Chamber of Commerce and others to engage summer interns at local businesses, to explain the benefits of living and working in Greater Boston after graduation. My colleague Paul Connolly, the Bank's Chief Operating Officer, has been a true leader in this work. These and other initiatives are described in more detail in the Bank Highlights section of this report.

With the financial crisis ebbing, in 2009 we worked hard to parse out, and apply, its lessons. We are, for example, reorienting our bank-supervisory activities in areas like capital adequacy, risk-management practices, liquidity management, and the effects on risk-taking of compensation structures. And we are augmenting traditional firm-specific oversight with a more comprehensive approach to anticipating and addressing threats to financial stability — a so-called "macroprudential" approach that goes beyond a focus on the safety and soundness of individual institutions to also focus on risks to the financial system as a whole.

Chief among the lessons I believe the nation should draw from the crisis is the need to address critical gaps in the U.S. financial regulatory framework. The much-discussed financial rescue of AIG, for example, highlights that no agency had direct supervisory oversight of complex high-risk activities undertaken by a large, interconnected nonbank financial institution; and once everything went wrong, no framework existed to "wind down" or resolve the institution in an orderly manner and minimize collateral damage.

I have on occasion used a highway metaphor for the country's lack of wind-down or resolution authority for important non-bank financial institutions — which in my thinking is the most pressing of several issues in financial regulatory reform. The financial system is akin to a highway that moves well most of the time. Car accidents occur, but cause only minor disruptions to traffic — although those involved in the accident may be seriously impacted. However, if something other than a car overturns — say a tractor-trailer carrying volatile materials — you need specialized emergency equipment that can clear away such an accident. In the absence of such equipment, the roadway grinds to an extended halt, and everyone is affected — not just those in the accident. Traffic jams may even spill over onto surface roads. We have been operating in a world where bank failures can be addressed with acceptable side effects, but the failures of large non-bank financial firms cannot. It is in everyone's interest that the tools exist to clear such "vehicles" and keep the "roadways" moving.

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There are many distasteful parts to the financial crisis and the choices that had to be made. The frustration many people feel is absolutely understandable. I would simply observe that the legal framework for resolution of non-bank financial institutions in an orderly, transparent, and more palatable manner did not exist — but should have, and must as we move ahead.

We are fortunate to have very dedicated staff at the Bank, and I want to thank them for their professionalism, engagement, and commitment to making a difference in the public's interest, especially during these challenging times. I also thank the members of our Board of Directors and the members of our advisory groups for the wealth of insights they shared with us from all corners of the New England economy.

I especially want to thank the three directors who completed terms of service on our board in 2009. Among their many contributions, Stuart Reese helped us greatly in launching our efforts in Springfield, and Robert Kraft hosted our first foreclosure-prevention event at his "home-away-from-home," Gillette Stadium. This workshop welcomed thousands of people in tough personal situations for a very unique event that made a difference. And during her time on the board, Lisa Lynch served as a director, deputy chair, and chair; she also headed the System's Conference of Chairs. I want to thank each of them, and our other directors, for their service and their clear focus on advancing economic well-being for the region and nation.

Eric Rosengren