The Federal Reserve Bank of San Francisco

1999 ANNUAL REPORT
Federal Reserve Bank of San Francisco

PERSPECTIVES ON A CENTURY OF CHANGE

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PERSPECTIVES ON A CENTURY OF CHANGE

from the boardroom

The year just ended was the culmination of several years of preparation to ensure the banking system's readiness for Y2K. In addition, it was a year in which we continued to respond efficiently and creatively to our customers' needs. Handling these diverse demands required exceptional dedication from our employees, and we thank them for their continued high level of achievement, professionalism, and dedication.

From left (standing):
John F. Moore, First Vice President
Nelson C. Rising, Deputy Chairman
Robert T. Parry, President

Seated:
Gary G. Michael, Chairman

It was also the year in which the entire Federal Reserve System celebrated its 85th year of service. At the end of 1913, President Woodrow Wilson signed the Federal Reserve Act, creating the Federal Reserve Banks that opened throughout the country the following year.

The influence of the Federal Reserve is now felt far beyond what the early founders could have imagined. Two of our directors profiled in this Report are from states that did not exist 85 years ago -- Alaska and Hawaii. In addition, the Pacific Rim countries are now a significant focus of this Bank.

Just this last summer, I, as president of the Federal Reserve Bank of San Francisco, was part of a delegation that visited central bankers in Japan and China. We were interested in learning more about economic and financial developments in their countries and gaining a better understanding of banking conditions and financial sector reforms that are taking place there. Information such as this, along with the invaluable grassroots information on local economic conditions provided to us by our directors, is key to the formulation of a successful monetary policy.

We want to extend particular thanks and appreciation to those directors and advisory council members who retired from Federal Reserve service at 1999 year end: on the Portland Branch Board, Gary T. Duim (Vice Chairman - Retired, U.S. Bancorp, Portland, OR); on the Salt Lake City Branch Board, Nancy S. Mortensen (Vice President - Marketing Services, Zions Cooperative Mercantile Institution, Salt Lake City, UT); from the Seattle Branch Board, Tomio Moriguchi (Chairman and CEO, Uwajimaya, Inc., Seattle, WA); and from the Twelfth District Advisory Council, its Chairman, Bailey (Biff) S. Barnard (Senior Vice President, Allied Capital Corporation, San Francisco, CA).

Gary G. Michael
Chairman

Robert T. Parry
President

The Federal Reserve Bank of San Francisco

ABOUT THE FED

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PERSPECTIVES ON A CENTURY OF CHANGE

perspectives on a century of change

by karen flamme

The Federal Reserve Bank of San Francisco, along with the rest of the Federal Reserve System, celebrated its 85th anniversary on November 16, 1999. It was on that day in 1914 that the San Francisco office officially opened for business in rented quarters at the rear of the Merchants National Bank. The staff consisted of a couple dozen employees, many on loan from local banks. They initially busied themselves receiving and counting gold from member banks, recording capital stock subscriptions, and issuing capital stock receipts. Things were to change rapidly in the next few years as check collection began and as the Federal Reserve Banks played a critical role in securing the funds necessary to carry on World War I.

Prior to the establishment of the Federal Reserve System, banking was marred by periodic financial panics that contributed to bank failures, business bankruptcies, and general economic depressions. Locally owned, independent banks flourished, many with dangerously low reserves. In 1907 a particularly severe loss of confidence in the stability of some banks caused yet another bank run and panic. It had become clear to many that the country needed an "elastic" currency that could increase in volume when the demands on banks necessitated it. Without that, there was no way for banks to bolster reserves when confronted with exceptional demands.

Congress responded by creating the National Monetary Commission, chaired by Senator Nelson W. Aldrich, to conduct a comprehensive study and recommend necessary and desirable changes to the money and banking system of the United States. This task was not an easy one. Nevertheless, within a couple of years, reform plans began to emerge. There ensued lengthy debates with battle lines generally being drawn between the progressives, primarily representing the small town businessman and farmer, and the conservatives, mainly representing the powerful eastern business and banking establishment.

Contentious arguments sprang up with each new proposal, but President Woodrow Wilson and his advisers persevered in developing and securing congressional passage of a monetary reform plan that became known as the Federal Reserve Act and that was ultimately signed into law on December 23, 1913. The Act stated that its purposes were "to provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes." The Federal Reserve Act combined central with regional power by dividing the country into 12 Federal Reserve districts, each under the supervision of a Federal Reserve Bank. At the apex of the new central banking system was the Federal Reserve Board in Washington, D.C., composed of the Secretary of the Treasury, the Comptroller of the Currency, and five others appointed by the President for 10-year terms. (Later, the Banking Act of 1935 changed the composition of the Board and renamed it the Board of Governors of the Federal Reserve System.)

All national banks in each district were required to join the Federal Reserve and those state banks that so chose could also join. (At the end of 1913 the U.S. had some 27,000 commercial banks -- more than twice as many state banks as national ones.) Member banks were required to invest six percent of their capital and surplus in their regional Reserve Bank. The Reserve Bank, in turn, could make loans to member banks by rediscounting their commercial paper, buy and sell government bonds, and issue a new currency -- Federal Reserve notes.

The Act stipulated that a nine-member board of directors representing the interests of banking, industry, commerce, agriculture, and the general public would govern each regional bank.

The summer of 1914 was a busy time for organizers of the Federal Reserve Bank of San Francisco. Directors were selected for the Twelfth District bank, office space was located, and a staff was hurriedly assembled.

The opening date for all Reserve Banks was set for November 16, 1914, in order to make the reserve provisions of the Federal Reserve Act effective even though it was clear that the banks wouldn't be ready for normal business transactions that quickly. War had broken out in Europe four months before the banks were set to open, and help from the banks was needed to alleviate the credit strain that was occurring.

When the doors first opened for business, it wasn't clear just what the business of Federal Reserve Banks would entail. There were no precedents to guide the banks, and each bank had to work out its own procedures.

In May of 1916 our Bank in San Francisco had 25 employees. The check collection operation started in July 1916, and by the end of that year the staff had more than doubled to about 60. In addition, U.S. participation in World War I put a tremendous workload on the Federal Reserve Banks as they carried out their role as fiscal agents of the government. The first Liberty Loan was floated in 1917, and the volume of work and number of employees increased rapidly. The Federal Reserve Banks actively promoted the sale of the four Liberty Loans and the Victory Loan, which were issued to raise funds to support the war effort.

The Bank also expanded geographically in 1917. In order to give good service to member banks throughout the District, the Spokane Branch was opened on July 26, followed by the Seattle Branch on September 19 and Portland on October 1. On April 1, 1918, the Salt Lake City Branch opened. It was nearly two years later -- January 2, 1920 -- that the Los Angeles Branch opened its doors. By May 1921 the District boasted a total staff of 1306 -- 637 at the head office and 669 at the five branches.

At the end of 1923 the San Francisco staff moved out of temporary locations and into the Bank's newly built headquarters at 400 Sansome Street, a location that it would occupy for the next 60 years. The Spokane Branch was closed in 1938, but the other branches remain in service to the present time.

Since those early days of central banking, further legislation has been enacted to clarify and supplement the Federal Reserve Act of 1913. Key laws that have affected the Federal Reserve are the Banking Act of 1935; the Employment Act of 1946; the 1970 amendments to the Bank Holding Company Act; the International Banking Act of 1978; the Full Employment and Balanced Growth Act of 1978; the Depository Institutions Deregulation and Monetary Control Act of 1980; the Financial Institutions Reform, Recovery, and Enforcement Act of 1989; and the Federal Deposit Insurance Corporation Improvement Act of 1991.

Today the Federal Reserve's duties fall into four general areas:

- conducting the nation's monetary policy by influencing the money and credit conditions in the economy in pursuit of full employment and stable prices;
- supervising and regulating banking institutions to ensure the safety and soundness of the nation's banking and financial system and to protect the credit rights of consumers;
- maintaining the stability of the financial system and containing systemic risk that may arise in financial markets; and
- providing certain financial services to the U.S. government, to the public, to financial institutions, and to foreign official institutions, including playing a major role in operating the nation's payments system.

The Federal Reserve System still operates as an independent agency of the United States government. In keeping with the founding philosophy that ensures autonomy and protects the central bank from short-term partisan political pressures, its operations are financed from its own resources. The entire System is subject to congressional oversight and makes regular reports to Congress on its activities and plans for monetary policy. However, the central bank's day-to-day policy and operational decisions do not require congressional or presidential approval.

The seven-member Board of Governors in Washington, D.C., oversees the Federal Reserve System. Its members are appointed by the President of the United States and confirmed by the Senate to serve 14-year terms, staggered so that one term expires each even-numbered year. The President designates a Chairman and Vice Chairman from the Board to serve four-year terms.

Each District Reserve Bank has a head office board of nine directors chosen from outside the Bank. Three directors are chosen by and represent banks that are members of the Federal Reserve System. The other directors, selected by District member banks or the Board of Governors, represent the general public.

Each of the Federal Reserve Bank of San Francisco's four branches -- Los

Angeles, Portland, Salt Lake City, and Seattle -- has its own seven-person Board of Directors, four appointed by the head office board and three by the Board of Governors.

These boards provide the Federal Reserve System with a wealth of grassroots information on economic conditions throughout the Twelfth District. In addition, directors oversee the Reserve Bank operations, select the Bank's president and first vice president, and advise the Bank's president and the Board of Governors on the general direction of monetary policy by recommending the Bank's discount rate -- the interest rate a Reserve Bank charges eligible financial institutions to borrow funds on a short-term basis.

The discount rate, open market operations, and reserve requirements are the three tools the Federal Reserve uses to conduct monetary policy. The primary tool is open market operations, as managed by the Federal Open Market Committee (FOMC). The FOMC is composed of the Board of Governors and five of the 12 Federal Reserve Bank presidents. The president of the Federal Reserve Bank of New York is a permanent member, and the other presidents serve one-year terms on a rotating basis. All 12 presidents participate in every FOMC discussion, but only those serving as members may vote. The actions taken by the FOMC regulate the amount of reserves available to depository institutions, set ranges for the growth of the monetary aggregates, and direct operations undertaken by the Federal Reserve in foreign exchange markets.

Responsibilities of the regional Reserve Banks have expanded considerably over the past 85 years, as have the staffing levels. The way our work is done also has changed dramatically. While a banker in 1914 was well equipped to handle a day's work with adding machines, punched card tabulators, typewriters, duplicating machines, and basic check-writing equipment, today's banker operates in an electronic world.

Reserve Banks provide banking services to both depository institutions and the federal government. For depository institutions, the Fed maintains reserve and clearing accounts and provides such payment services as processing checks, electronically transferring funds, and distributing and receiving currency and coin. Fedwire electronic transfers of funds and securities in the District now average 118,400 per day, for a dollar volume of $124 billion. Check-processing machinery, operating at speeds up to 100,000 checks per hour, handles approximately 8.9 million checks per day, six days a week.

The Federal Reserve acts as the banker, or fiscal agent, for the federal government. It maintains the U.S. Treasury Department's transaction accounts; pays Treasury checks; processes electronic payments; conducts nationwide auctions of Treasury securities; and issues, services, and redeems U.S. government securities.

As the banking system has grown, so has the supervisory and regulatory role of the Federal Reserve. Fed personnel work in conjunction with other federal and state financial authorities to ensure the financial soundness of financial institutions and the fair and equitable treatment of consumers in their financial dealings.

From its beginning as the westernmost outpost of the Federal Reserve System, the Twelfth District has grown to rank first in the size of its economy. Its 53.2 million

people account for 19.7 percent of the total U.S. population, and its $1.42 trillion annual personal income accounts for 19.9 percent of the nation's total personal income. And the District continues to grow.

In 1921 an employee writing in the Bank's employee publication reflected on the Bank's first seven years of growth and predicted, "In the expansion and development of the Federal Reserve System in the years to come there will be new and interesting problems with which to wrestle. In their solution will come opportunities for all thinking men of ability, energy, and vision." The author was wrong about gender, but got the rest of it right.

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directors' perspectives

warren k.k. luke | betsy lawer | a.w. clausen

warren k.k. luke

Head Office Director Warren K. K. Luke describes his family's bank -- Hawaii National Bank -- as a community bank. It was founded in 1960 by his father K.J. Luke, whose ancestors came to Hawaii from China in the 1870s and began then to establish deep roots in the Hawaiian community. Opening day of the bank was record setting for the only federally chartered bank in Hawaii. By the 3 p.m. closing time, the bank had $6.25 million in deposits, and now, some 40 years later, it has expanded to 13 offices. K.J. Luke is now chairman emeritus of the board, and daily operations are overseen by son Warren, chairman and president, who has been an officer of the bank since 1972.

The similarities between father and son are striking -- both graduated from Harvard University's Graduate School of Business, both started their business careers in real estate development, both have four children, and both are committed to maintaining a true community bank.

Because it is a small, local bank, Hawaii National Bank's prosperity is directly linked to the prosperity of the Hawaiian economy, which has been in a downward spiral for the past 10 years. Businesses have had to adjust to this situation, and recently the decision was made to buy out shareholders, go private, and make the bank family-owned to accomplish its long-term goals. Warren Luke explains that keeping the bank accessible to all its customers and developing strong personal relationships is a critical adjunct to the technology that his bank also embraces. He believes that these hard economic times bring out entrepreneurs who can benefit from a strong relationship with a community banker.

It is this type of grassroots information on both the Hawaiian and Pacific Rim economies that Luke brings to the Federal Reserve Bank of San Francisco as he serves his third term as the first director from Hawaii.

Serving on the Fed board is but one of Luke's many public service commitments. He holds leadership positions in numerous banking, educational, charitable, and community organizations on local, regional, and national levels. In addition, he remains active in various aspects of real estate management and development.

In the 10 years since Hawaii became a state and Hawaii National Bank opened its doors, the Luke family has witnessed a lot of changes. In the early days business was often done on a handshake, and people thought very hard before they filed for bankruptcy. Many of the local businesses that started soon after the war are now being taken over by the next generation. These businesses must now make some tough decisions about whether they can continue to operate as a closely held or family business. When Luke talks to his customers about concerns such as these, he understands their situation because he has gone through it himself. In fact, it is giving just that kind of service -- helping customers succeed in business as well as in family relationships -- that is most rewarding to him as a banker.

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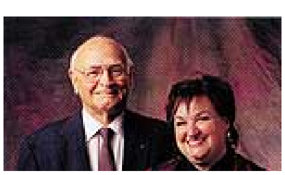
betsy lawer

When Seattle Branch Director Betsy Lawer tells you she grew up in the family bank, she really means it.

At the time she was born, her parents lived in a second story apartment in the building that housed the First National Bank of Anchorage, and she remembers chatting with (and dropping toys on) customers as they entered the bank.



The bank was founded in 1922, and in 1941 Lawer's grandfather, Warren N. Cuddy, bought a controlling interest and became the bank's president, beginning a family legacy which would last into the next century. His son, D. H. Cuddy, succeeded him and still serves as chairman of the board and president of the bank. Granddaughter Betsy Lawer continues the family enterprise as vice chairman and chief operating officer.

As the eldest of six, Lawer had the privilege as a child to accompany her father on his Saturday morning customer calls to Alaska businessmen, many of them independent souls who had built their own businesses. She listened, learned, and developed a strong respect and admiration for the personal aspects of banking.

She began working for the bank during summer vacations as soon as she could, progressing through a wide variety of jobs.

Looking back, Lawer recalls Alaska's first oil lease sale in 1969 in Prudhoe Bay and the tremendous impact it had on the future of the state. The sale netted over $900 million, and deposits on that sum were loaded into bags and flown by chartered jet to New York City because its location in the Eastern Standard Time zone allowed the money to earn an additional day's interest. First National Bank of Anchorage aided in supervising the transaction, and Lawer, on her way back to college at Duke University, was lucky enough to ride along in that chartered jet. She returned to college and promptly changed her major to economics. Now, as a director of the Federal Reserve Bank of San Francisco, she appreciates being able to apply her theoretical education in economics.

Lawer keeps her finger on the pulse of the community, both as a banker and as a community leader. Her grandmother, a former chairman of the bank, headed the first United Way drive in Alaska, and Lawer is proud to follow in her footsteps. As a community banker, she balances the diverse needs of the populations served by the bank's 28 locations -- ranging from rural fishing villages to metropolitan cities. In each case, understanding the customers' banking needs in order to provide them with the service and technology they need to do business remains the bank's primary goal.

Lawer provides critical input to the Seattle Branch Board on Alaska's economy. Because Alaska's economy is relatively small, small changes in it make a big difference, and its importance as an international export hub is significant. She also uses the Fed as an important resource for advice and counsel in operational areas.While the Alaskan economy and the customer base have changed dramatically during her family's years with First National Bank of Anchorage, Lawer is proud that the bank's guiding philosophy, as stated by her grandfather more than 50 years ago, is still intact. The goals are: safeguard the depositors' money, serve the community in which the bank operates to the limits of the bank's deposits, capital, and personnel; and provide the employees with adequate wages, the tools to do their jobs, and a comfortable place to work. And, if you do that, a proper return is earned for the shareholders.

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a.w. clausen

A. W. Clausen has a long, distinguished career in banking. In 1970, at age 46, he was selected to head Bank of America and over the next 20 years served as its president, chairman, and chief executive officer. During the 1970s he also served terms as president and Twelfth District member of the Federal Advisory Council (for the Board of Governors of the Federal Reserve) and as a director of the Federal Reserve Bank of San Francisco. Clausen left Bank of America in 1981 to serve a term as president of the World Bank, then returned to lead Bank of America. Now, in his retirement, Clausen remains an involved participant in banking and business issues, particularly in the international arena.

Perhaps, surprisingly, it was the love of a young lady, not the love of banking, that initially got him into the business. Clausen arrived in Los Angeles in 1949 after graduating from the University of Minnesota law school to "woo and pursue" his sweetheart. He took a job counting cash for Bank of America at $180 per month and thus began what would turn out to be a banking career - and a marriage - that would span the next 50 years.

In 1949, when Clausen joined Bank of America, college graduates, especially those with an added law degree, were in short supply. He was soon selected for the bank's two-year management training program rotating through a variety of assignments. He held several permanent branch assignments and then was promoted to bank administration in the corporate finance area. In 1963 he moved to San Francisco as head of the corporate finance department in northern California. Seven years later he was named president and chief executive officer.

During his career Clausen has seen the Federal Reserve both from the inside - as a director and Federal Advisory Council member -- and from the outside -- as a customer. Clausen recalls his service on the Fed board as a learning experience affording him the opportunity for a behind-the-scenes look at how the Fed operates and why it has certain rules and regulations. He remembers being on the customer side of dealing with the Fed during troubled financial times at B of A, and, as he reflects on those times, he encourages the Fed to continue its assertiveness in bringing discipline to the banking system. He also commends the Fed for having an increasingly enlightened view of commercial banks and for adopting regulations that recognize the more competitive world in which commercial banks operate today.

When asked to comment on major changes in banking over the past 50 years, Clausen is quick to cite paper processing as number one. He is proud that Bank of America was at the forefront of developing the magnetic ink character recognition system for check handling, which had significant ramifications in reducing float and speeding processing throughout the world.

Looking forward, Clausen is excited about the impact of the Internet and the possibilities it affords for the future of banking, and he hopes the financial sector will not fight it, but will use it to its fullest advantage.

From his vantage point at the head of the world's largest commercial bank, Clausen faced challenges and helped lead the vast growth and change in banking. He says he's very lucky to have had these opportunities, and, when asked to pass along his secret of success, he quotes an inscription on a piece of driftwood he treasures: "When all else fails, don't forget sheer dumb luck."

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highlights of 1999

The primary focus of our Bank during 1999 was to ensure the banking system's operational readiness for the transition to the year 2000. Our activities capped off a multi-year effort to prepare our internal systems and to ensure the preparedness of financial institutions' systems that support the nation's payments systems. As a regulator of financial institutions and the nation's money manager, our charter directs us to ensure safety and soundness in the operations of financial institutions, to provide stability in financial markets, and to maintain the smooth functioning of the nation's payments system.

Throughout the year we tested applications with the depository institutions that are our customers, implemented updated systems, reviewed institutions' readiness plans, and regularly communicated our progress to the public. We produced the brochure "How Is the Banking Industry Preparing for Y2K?" in four languages and distributed it to more than 150,000 constituents, along with providing speakers on the subject of Y2K readiness for 45 events and 22 seminars. Our Bank's credit and risk management area prepared District financial institutions to obtain short-term credit in the event of Y2K-related liquidity problems. We also devoted considerable resources to ensuring that adequate supplies of cash would be available to meet the higher demand for currency expected in the days leading up to the century rollover weekend.

Financial Services

The Bank did not allow its Y2K preparations to eclipse other critical, long-standing objectives. In our financial services functions, we continued to focus on promoting electronic transactions and transitioning customers from paper-based delivery of transaction information to electronic delivery. In addition, we prepared for the Systemwide consolidation of two of our fiscal agency functions, TreasuryDirect and Treasury Tax and Loan (TT&L), in 2000.

Executive Committe

From left (standing): Gordon R.G. Werkema, Executive Vice President; John F. Moore, First Vice President; Jack H. Beebe, Senior Vice President and Director of Research

From left (seated): Terry S. Schwakopf, Senior Vice President; Robert T. Parry, President

In another significant event, we received final approval from the Board of Governors to establish a cash operations center in Phoenix to meet the cash needs of the growing Arizona market. We will break ground on that facility in the spring of 2000in preparation for a September 2001 opening.

In the retail payments area, the Bank continued to promote electronic payments and electronic collection of paper-based payments by offering competitive and innovative services. The Bank's Automatic Bill Payment (ABP) Program is a joint marketing program that enables utilities, municipalities, and newspapers that share common customers to coordinate direct payment promotional efforts using a common enrollment form. The San Francisco Bay Area ABP Program, which started in 1997, now includes 14 billers and 30 financial institutions with a total of 222,000 enrollments.

In addition, the Bank provided project leadership for the Treasury Point of Sale Check Conversion project, which is testing the feasibility and consumer acceptance of converting check payments made at the point of sale to ACH debit transactions for faster processing and speedier collection. By year-end, the U.S. Patent Office had two payment terminals generating ACH debits, and a number of other Treasury agencies were on track to convert checks in 2000, including the Department of Veterans Affairs Canteen Service, the Bureau of Printing and Engraving, and the U.S. Customs Office.

Also, to promote electronic collection of checks, the Bank expanded its pilot of "Deposit MICR" services, adding a sizable financial institution with subsidiary banks in the Portland and Seattle zones to its customer base. The Bank's pilot of deposit MICR services includes the capture, sorting and imaging of transit and "on us" checks, as well as "proof of deposit" type services and item encoding. By enabling financial institutions to eliminate back office operations associated with handling paper items, these services make electronic check collection much more economical for financial institutions, particularly when they also provide images of paid items in their customers' monthly account statements in lieu of returning the physical items.

In order to provide higher levels of service and operate more efficiently through enhanced automation platforms, we continued to lead the Enterprise-wide Check Adjustments (EWA) project for the System. This application is the largest distributed processing application in the Federal Reserve. It will provide improved cross-District adjustments processing capabilities, as well as a platform for Web-based submission and tracking of cases, resulting in better efficiency in back room operations and enhanced services to both local and national customers.

Economic Research

The Bank contributes to the formulation of sound monetary and regulatory policy through academic research on topics of policy concern to the Federal Reserve, timely and high-quality data reporting, and outreach to increase the public's understanding of the Federal Reserve as the nation's central bank.

Research efforts in 1999 were concentrated in three key areas: structural change in the economy and the conduct of monetary policy, financial crises in emerging-market economies, and financial services industry restructuring and supervisory policy.

The Bank's Center for Pacific Basin Monetary and Economic Studies hosted an international conference on the theme "Financial Crises in Emerging Markets." The event brought together nearly 100 researchers and policymakers from foreign central banks, international organizations, academia, and the Federal Reserve to discuss the role of the financial sector in the occurrence of banking and currency crises in emerging market countries, particularly in Asia.

Branch Operations

From left (standing):
Gordon R.G. Werkema, Executive Vice President, Northern Region; Raymond H. Laurence, Senior Vice President-in-Charge, Portland; Mark Mullinix, Senior Vice President-in-Charge, Los Angeles

Seated:
Andrea P. Wolcott, Vice President-in-Charge, Salt Lake City

Banking Supervision and Regulation

In addition to handling successfully its Y2K-related supervisory responsibilities, the Bank's supervision function continued to focus on emerging risks, particularly in the supervision of large, complex banking organizations (LCBOs). In this regard, we deepened our expertise in global bank supervision, the supervision of new information technologies used in the delivery of financial services, and credit risk modeling techniques used by financial institutions. We also enhanced our Asia supervision program and our reputation as a leading expert in Asia. We continued to strengthen our safety and soundness and compliance supervisory programs for regional and community banking organizations by focusing on ongoing monitoring of, and outreach to, our supervised entities. In this matter, we were able to address emerging issues in a timely, cooperative manner.

In the Community Affairs area, the Bank continued to develop innovative outreach programs and to promote partnerships between financial institutions and community groups, focusing particularly on increasing the availability of credit to tribal lands. In this regard, the Bank convened and facilitated 25 meetings for bankers and tribal representatives on various Indian reservations in the Pacific Northwest, Idaho, and Utah. These gatherings have resulted in several financial institutions developing tribe-specific partnerships with loan commitments for mortgage and commercial lending on tribal lands.

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summary of operations

Volume (in thousands)

	1997	1998	1999
Custody Services			
Cash Services			
Currency notes paid into circulation	4,626,649	4,739,673	5,369,630
Food stamp coupons processed	654,068	483,942	367,350
Securities Services			
Other Treasury original issues	105	76	63
Book-entry securities processed	751	673	527
Payments Services			
Check Services			
Commercial checks collected	2,313,792	2,312,860	2,312,940
Government checks processed	54,466	52,103	46,034
Return items processed	35,251	34,591	33,849
Electronic Payments Services			
Wire transfers processed	24,058	26,622	27,088
Automated clearinghouse transactions processed	428,564	499,527	574,872
Discounts & Advances			
Total discounts & transactions*	478	463	647
Number of financial institutions accommodated*	86	77	130

**Whole number (not in thousands)*

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bank officers

as of december 31, 1999

Robert T. Parry
President and Chief Executive Officer

John F. Moore
First Vice President
and Chief Operating Officer

Jack H. Beebe
Senior Vice President
and Director of Research

Sara K. Garrison
Senior Vice President

Michael J. Murray
Senior Vice President

Terry S. Schwakopf
Senior Vice President

Susan A. Sutherland
Senior Vice President

D. Kerry Webb
Senior Vice President

John H. Parrish
General Auditor

Jet Auer de Saram
Vice President and General Counsel

Elizabeth R. Masten
Vice President and
Secretary of the Board

Frederick T. Furlong
Vice President

Reuven Glick
Vice President

John P. Judd
Vice President and
Associate Director of Research

Donald R. Lieb
Vice President

Ronald E. Mitchell, Jr.
Vice President

Robert D. Mulford
Vice President and Counsel

Elizabeth M. O'Shea
Vice President

Deborah S. Smyth
Vice President

Michael J. Stan

Barbara J. Beckman
Assistant Vice President

Thomas R. Burke
Assistant Vice President

Richard K. Cabral
Assistant Vice President

James J. Callahan
Assistant Vice President

Teresa M. Curran
Assistant Vice President

Lee C. Dwyer
Assistant Vice President

Alice Farrell
Assistant Vice President

Louis "Skip" George
Assistant Vice President

Todd A. Glissman
Assistant Vice President

Ellen M. Hamilton
Assistant Vice President

Beverley-Ann Hawkins
Assistant Vice President

Peter K. C. Hsieh
Assistant Vice President

Michael E. Johnson
Assistant Vice President

Craig B. Knudsen
Assistant Vice President

Mark Levonian
Assistant Vice President

Ellsworth E. Lund, Jr.
Assistant Vice President

Joy Hoffmann Molloy
Assistant Vice President

Darren S. Post

Assistant Vice President

Philip M. Ryan
Assistant Vice President

Daniel K. Shaw
Assistant Vice President

Gordon S. Tannura
Assistant Vice President

James J. Tenge

Sallie H. Weissinger
Vice President and
Director of Public Information

Patricia A. Welch
Vice President

James M. Barnes
Director

Kenneth R. Binning
Director

Harold H. Blum
Director

Eliot E. Giuili
Director

Andreas Hauer
Director

John S. Hsiao
Director

Ann Marie Kohlligian
Director

David W. Walker
Director

Kenneth M. Kinoshita
Associate General Counsel

Bonnie R. Allen
Assistant Vice President

James J. Tenge
Assistant Vice President

Dale L. Vaughn
Assistant Vice President

Elizabeth L. Wood
Assistant Vice President

Angela D'Alessandro
Examining Officer
(On loan to the Board)

Barbara A. Bennett
Strategic Planning Officer

Joseph P. Mattey
Research Officer

Gary P. Palmer
Banking Studies Officer

Glenn D. Rudebusch
Research Officer

Mark Spiegel
Research Officer

Bharat Trehan
Research Officer

Roxana R. Tsougarakis
Financial Planning and Control Officer

Mary E. Wujek
Information and Technology
Services Officer

Los Angeles Branch

Mark Mullinix
Senior Vice President

Robert G. Wiley
Vice President

Roger W. Replogle
Director

Marla E. Borowski
Assistant Vice President

Robert C. Johnson
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The Federal Reserve Bank of San Francisco

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December 31, 1999

To: PricewaterhouseCoopers LLP

The management of the Federal Reserve Bank of San Francisco (FRB-SF) 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, 1999 (the "Financial Statements"). The Financial Statements have been prepared in conformity with the 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 the Federal Reserve Banks, and as such, include amounts, some of which are based on judgments and estimates of management.

The management of the FRB-SF 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 an effective process of internal controls, no matter how well designed, has inherent limitations, including the possibility of human error, and therefore can provide only reasonable assurance with respect to the preparation of reliable financial statements.

The management of the FRB-SF assessed its process of 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 FRB-SF believes that the FRB-SF maintained an effective process of internal controls over financial reporting including the safeguarding of assets as they relate to the Financial Statements.

Federal Reserve Bank of San Francisco

by
Robert T. Parry
President

Robert T. Parry

by
John F. Moore
First Vice President

John F. Moore

PRICEWATERHOUSECOOPERS

To the Board of Directors of the
Federal Reserve Bank of San Francisco

We have examined management's assertion that the Federal Reserve Bank of San Francisco ("the Bank") maintained effective internal control over financial reporting and the safeguarding of assets as they relate to the financial statements as of December 31, 1999, 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 Bank maintained effective internal control over financial reporting and over the safeguarding of assets as they relate to the financial statements as of December 31, 1999, is fairly stated, in all material respects, based upon criteria described in " Internal Control - Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission.

PricewaterhouseCoopers LLP

San Francisco, California
March 3, 2000

PRICEWATERHOUSECOOPERS

Report of Independent Accountants

To the Board of Directors of The Federal Reserve System
and the Board of Directors of the Federal Reserve Bank of San Francisco

We have audited the accompanying statements of condition of The Federal Reserve Bank of San Francisco (the "Bank") as of December 31, 1999 and 1998, and the related statements of income and changes in capital for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 3, the financial statements were prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of The Federal Reserve System. These principles, policies, and practices, which were designed to meet the specialized accounting and reporting needs of The Federal Reserve System, are set forth in the "Financial Accounting Manual for Federal Reserve Banks" and constitute a comprehensive basis of accounting other than accounting principles generally accepted in the United States.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank as of December 31, 1999 and 1998, and results of its operations for the years then ended, on the basis of accounting described in Note 3.

PricewaterhouseCoopers LLP

San Francisco, CA

March 3, 2000

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1. **Organization**

   The Federal Reserve Bank of San Francisco ("Bank") is part of the Federal Reserve System ("System") created by Congress under the Federal Reserve Act of 1913 ("Federal Reserve Act") which established the central bank of the United States. The System consists of the Board of Governors of the Federal Reserve System ("Board of Governors") and twelve Federal Reserve Banks ("Reserve Banks"). The Reserve Banks are chartered by the federal government and possess a unique set of governmental, corporate, and central bank characteristics. Other major elements of the System are the Federal Open Market Committee ("FOMC") and the Federal Advisory Council. The FOMC is composed of members of the Board of Governors, the president of the Federal Reserve Bank of New York ("FRBNY") and, on a rotating basis, four other Reserve Bank presidents.

   Structure
   The Bank and its branches in Los Angeles, California, Portland, Oregon, Salt Lake City, Utah, and Seattle, Washington, serve the Twelfth Federal Reserve District, which includes Alaska, Arizona, California, Hawaii, Idaho, Nevada, Oregon, Utah, Washington, and the commonwealths or territories of American Samoa, Guam, and the Northern Mariana Islands. In accordance with the Federal Reserve Act, supervision and control of the Bank is exercised by a board of directors. Banks that are members of the System include all national banks and any state chartered bank that applies and is approved for membership in the System.

   Board of Directors
   The Federal Reserve Act specifies the composition of the board of directors for each of the Reserve Banks. Each board is composed of nine members serving three-year terms: three directors, including those designated as Chairman and Deputy Chairman, are appointed by the Board of Governors, and six directors are elected by member banks. Of the six elected by member banks, three represent the public and three represent member banks. Member banks are divided into three classes according to size. Member banks in each class elect one director representing member banks and one representing the public. In any election of directors, each member bank receives one vote, regardless of the number of shares of Reserve Bank stock it holds.

2. **Operations and Services**

   The System performs a variety of services and operations. Functions include: formulating and conducting monetary policy; participating actively in the payments mechanism, including large-dollar transfers of funds, automated clearinghouse operations and check processing; distribution of coin and currency; fiscal agency functions for the U.S. Treasury and certain federal agencies; serving as the federal government's bank; providing short-term loans to depository institutions; serving the consumer and the community by providing educational materials and information regarding consumer laws; supervising bank holding companies, and state member banks; and administering other regulations of the Board of Governors. The Board of Governors' operating costs are funded through assessments on the Reserve Banks.

   The FOMC establishes policy regarding open market operations, oversees these operations, and issues authorizations and directives to the FRBNY for its execution of transactions. Authorized transaction types include direct purchase and sale of securities, matched sale-purchase transactions, the purchase of securities under agreements to resell, and the lending of U.S. government securities. Additionally, the FRBNY is authorized by the FOMC to hold balances of and to execute spot and forward foreign exchange and securities contracts in fourteen foreign currencies, maintain reciprocal currency arrangements ("F/X swaps") with various central banks, and "warehouse" foreign currencies for the U.S. Treasury and Exchange Stabilization Fund ("ESF") through the Reserve Banks.

3. **Significant Accounting Policies**

   Accounting principles for entities with the unique powers and responsibilities of the nation's central bank have not been formulated by the Financial Accounting Standards Board. The Board of Governors has developed specialized accounting principles and practices that it believes are appropriate for the significantly different nature and function of a central bank as compared to the private sector. These accounting principles and practices are documented in the "Financial Accounting Manual for Federal Reserve Banks" ("Financial Accounting Manual"), which is issued by the Board of Governors. All Reserve Banks are required to adopt and apply accounting policies and practices that are consistent with the Financial Accounting Manual.

The financial statements have been prepared in accordance with the Financial Accounting Manual. Differences exist between the accounting principles and practices of the System and generally accepted accounting principles in the United States ("GAAP"). The primary differences are the presentation of all security holdings at amortized cost, rather than at the fair value presentation requirements of GAAP, and the accounting for matched sale-purchase transactions as separate sales and purchases, rather than secured borrowings with pledged collateral, as is required by GAAP. In addition, the Bank has elected not to present a Statement of Cash Flows or a Statement of Comprehensive Income. The Statement of Cash Flows has not been included as the liquidity and cash position of the Bank are not of primary concern to the users of these financial statements. The Statement of Comprehensive Income, which comprises net income plus or minus certain adjustments, such as the fair value adjustment for securities, has not been included because as stated above the securities are recorded at amortized cost and there are no other adjustments in the determination of Comprehensive Income applicable to the Bank. Other information regarding the Bank's activities is provided in, or may be derived from, the Statements of Condition, Income, and Changes in Capital. Therefore, a Statement of Cash Flows or a Statement of Comprehensive Income would not provide any additional useful information. There are no other significant differences between the policies outlined in the Financial Accounting Manual and GAAP.

The preparation of the financial statements in conformity with the Financial Accounting Manual requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Unique accounts and significant accounting policies are explained below.

Gold Certificates
The Secretary of the Treasury is authorized to issue gold certificates to the Reserve Banks to monetize gold held by the U.S. Treasury. Payment for the gold certificates by the Reserve Banks is made by crediting equivalent amounts in dollars into the account established for the U.S. Treasury. These gold certificates held by the Reserve Banks are required to be backed by the gold of the U.S. Treasury. The U.S. Treasury may reacquire the gold certificates at any time and the Reserve Banks must deliver them to the U.S. Treasury. At such time, the U.S. Treasury's account is charged and the Reserve Banks' gold certificate accounts are lowered. The value of gold for purposes of backing the gold certificates is set by law at $42 2/9 a fine troy ounce. The Board of Governors allocates the gold certificates among Reserve Banks once a year based upon Federal Reserve notes outstanding in each District at the end of the preceding year.

Special Drawing Rights Certificates
Special drawing rights ("SDRs") are issued by the International Monetary Fund ("Fund") to its members in proportion to each member's quota in the Fund at the time of issuance. SDRs serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for United States participation in the SDR system, the Secretary of the U.S. Treasury is authorized to issue SDR certificates, somewhat like gold certificates, to the Reserve Banks. At such time, equivalent amounts in dollars are credited to the account established for the U.S. Treasury, and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDRs, at the direction of the U.S. Treasury, for the purpose of financing SDR certificate acquisitions or for financing exchange stabilization operations. The Board of Governors allocates each SDR transaction among Reserve Banks based upon Federal Reserve notes outstanding in each District at the end of the preceding year.

Loans to Depository Institutions
The Depository Institutions Deregulation and Monetary Control Act of 1980 provides that all depository institutions that maintain reservable transaction accounts or nonpersonal time deposits, as defined in Regulation D issued by the Board of Governors, have borrowing privileges at the discretion of the Reserve Banks. Borrowers execute certain lending agreements and deposit sufficient collateral before credit is extended. Loans are evaluated for collectibility, and currently all are considered collectible and fully collateralized. If any loans were deemed to be uncollectible, an appropriate reserve would be established. Interest is recorded on the accrual basis and is charged at the applicable discount rate established at least every fourteen days by the Board of Directors of the Reserve Banks, subject to review by the Board of Governors. However, Reserve Banks retain the option to impose a surcharge above the basic rate in certain circumstances.

The Board of Governors established a Special Liquidity Facility (SLF) to make discount window credit readily available to depository institutions in sound financial condition around the century date change (October 1, 1999, to April 7, 2000) in order to meet unusual liquidity demands and to allow institutions to confidently commit to supplying loans to other institutions and businesses during this period. Under the SLF, collateral requirements are unchanged from normal discount window activity and loans are made at a rate of 150 basis points above FOMC's target federal funds rate.

U.S. Government and Federal Agency Securities and Investments Denominated in Foreign Currencies
The FOMC has designated the FRBNY to execute open market transactions on its behalf and to hold the resulting securities in the portfolio known as the System Open Market Account ("SOMA"). In addition to authorizing and directing operations in the domestic securities market, the FOMC authorizes and directs the FRBNY to execute operations in foreign markets for major currencies in

in carrying out the System's central bank responsibilities.

Purchases of securities under agreements to resell and matched sale-purchase transactions are accounted for as separate sale and purchase transactions. Purchases under agreements to resell are transactions in which the FRBNY purchases a security and sells it back at the rate specified at the commencement of the transaction. Matched sale-purchase transactions are transactions in which the FRBNY sells a security and buys it back at the rate specified at the commencement of the transaction.

Effective April 26, 1999, FRBNY was given the sole authorization by the FOMC to lend U.S. government securities held in the SOMA to U.S. government securities dealers and to banks participating in U.S. government securities clearing arrangements, in order to facilitate the effective functioning of the domestic securities market. These securities-lending transactions are fully collateralized by other U.S. government securities. FOMC policy requires FRBNY to take possession of collateral in amounts in excess of the market values of the securities loaned. The market values of the collateral and the securities loaned are monitored by FRBNY on a daily basis, with additional collateral obtained as necessary. The securities loaned continue to be accounted for in the SOMA. Prior to April 26, 1999 all Reserve Banks were authorized to engage in such lending activity.

Foreign exchange contracts are contractual agreements between two parties to exchange specified currencies, at a specified price, on a specified date. Spot foreign contracts normally settle two days after the trade date, whereas the settlement date on forward contracts is negotiated between the contracting parties, but will extend beyond two days from the trade date. The FRBNY generally enters into spot contracts, with any forward contracts generally limited to the second leg of a swap/warehousing transaction.

The FRBNY, on behalf of the Reserve Banks, maintains renewable, short-term F/X swap arrangements with authorized foreign central banks. The parties agree to exchange their currencies up to a pre-arranged maximum amount and for an agreed upon period of time (up to twelve months), at an agreed upon interest rate. These arrangements give the FOMC temporary access to foreign currencies that it may need for intervention operations to support the dollar and give the partner foreign central bank temporary access to dollars it may need to support its own currency. Drawings under the F/X swap arrangements can be initiated by either the FRBNY or the partner foreign central bank, and must be agreed to by the drawee. The F/X swaps are structured so that the party initiating the transaction (the drawer) bears the exchange rate risk upon maturity. The FRBNY will generally invest the foreign currency received under an F/X swap in interest-bearing instruments.

Warehousing is an arrangement under which the FOMC agrees to exchange, at the request of the Treasury, U.S. dollars for foreign currencies held by the Treasury or ESF over a limited period of time. The purpose of the warehousing facility is to supplement the U.S. dollar resources of the Treasury and ESF for financing purchases of foreign currencies and related international operations.

In connection with its foreign currency activities, the FRBNY, on behalf of the Reserve Banks, may enter into contracts which contain varying degrees of off-balance sheet market risk, because they represent contractual commitments involving future settlement, and counter-party credit risk. The FRBNY controls credit risk by obtaining credit approvals, establishing transaction limits, and performing daily monitoring procedures.

While the application of current market prices to the securities currently held in the SOMA portfolio and investments denominated in foreign currencies may result in values substantially above or below their carrying values, these unrealized changes in value would have no direct effect on the quantity of reserves available to the banking system or on the prospects for future Reserve Bank earnings or capital. Both the domestic and foreign components of the SOMA portfolio from time to time involve transactions that can result in gains or losses when holdings are sold prior to maturity. However, decisions regarding the securities and foreign currencies transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, earnings and any gains or losses resulting from the sale of such currencies and securities are incidental to the open market operations and do not motivate its activities or policy decisions.

U.S. government and federal agency securities and investments denominated in foreign currencies comprising the SOMA are recorded at cost, on a settlement-date basis, and adjusted for amortization of premiums or accretion of discounts on a straight-line basis. Interest income is accrued on a straight-line basis and is reported as "Interest on U.S. government and federal agency securities" or "Interest on foreign currencies," as appropriate. Income earned on securities lending transactions is reported as a component of "Other income." Gains and losses resulting from sales of securities are determined by specific issues based on average cost. Gains and losses on the sales of U.S. government and federal agency securities are reported as "Government Securities Gains (Losses), Net." Foreign currency denominated assets are revalued monthly at current market exchange rates in order to report these assets in U.S. dollars. Realized and unrealized gains and losses on investments denominated in foreign currencies are reported as "Foreign Currency Gains (Losses), Net." Foreign currencies held through F/X swaps, when initiated by the counter party, and warehousing arrangements are revalued monthly, with the unrealized gain or loss reported by the FRBNY as a component of "Other assets" or "Other liabilities," as appropriate.

Balances of U.S. government and federal agencies securities bought outright, investments

Balances of U.S. government and federal agencies securities bought outright, investments denominated in foreign currency, interest income, amortization of premiums and discounts on securities bought outright, gains and losses on sales of securities, and realized and unrealized gains and losses on investments denominated in foreign currencies, excluding those held under an F/X swap arrangement, are allocated to each Reserve Bank. Effective April 26, 1999, income from securities lending transactions undertaken by FRBNY was also allocated to each Reserve Bank. Securities purchased under agreements to resell and unrealized gains and losses on the revaluation of foreign currency holdings under F/X swaps and warehousing arrangements are allocated to the FRBNY and not to other Reserve Banks.

Bank Premises and Equipment
Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over estimated useful lives of assets ranging from 2 to 50 years. New assets, major alterations, renovations and improvements are capitalized at cost as additions to the asset accounts. Maintenance, repairs and minor replacements are charged to operations in the year incurred.

Interdistrict Settlement Account
At the close of business each day, all Reserve Banks and branches assemble the payments due to or from other Reserve Banks and branches as a result of transactions involving accounts residing in other Districts that occurred during the day's operations. Such transactions may include funds settlement, check clearing and automated clearinghouse ("ACH") operations, and allocations of shared expenses. The cumulative net amount due to or from other Reserve Banks is reported as the "Interdistrict settlement account."

Federal Reserve Notes
Federal Reserve notes are the circulating currency of the United States. These notes are issued through the various Federal Reserve agents to the Reserve Banks upon deposit with such Agents of certain classes of collateral security, typically U.S. government securities. These notes are identified as issued to a specific Reserve Bank. The Federal Reserve Act provides that the collateral security tendered by the Reserve Bank to the Federal Reserve Agent must be equal to the sum of the notes applied for by such Reserve Bank. In accordance with the Federal Reserve Act, gold certificates, special drawing rights certificates, U.S. government and agency securities, loans, and investments denominated in foreign currencies are pledged as collateral for net Federal Reserve notes outstanding. The collateral value is equal to the book value of the collateral tendered, with the exception of securities, whose collateral value is equal to the par value of the securities tendered. The Board of Governors may, at any time, call upon a Reserve Bank for additional security to adequately collateralize the Federal Reserve notes. The Reserve Banks have entered into an agreement which provides for certain assets of the Reserve Banks to be jointly pledged as collateral for the Federal Reserve notes of all Reserve Banks in order to satisfy their obligation of providing sufficient collateral for outstanding Federal Reserve notes. In the event that this collateral is insufficient, the Federal Reserve Act provides that Federal Reserve notes become a first and paramount lien on all the assets of the Reserve Banks. Finally, as obligations of the United States, Federal Reserve notes are backed by the full faith and credit of the United States government.

The "Federal Reserve notes outstanding, net" account represents Federal Reserve notes reduced by cash held in the vaults of the Bank of $20,956 million, and $17,310 million at December 31, 1999 and 1998, respectively.

Capital Paid-in
The Federal Reserve Act requires that each member bank subscribe to the capital stock of the Reserve Bank in an amount equal to 6% of the capital and surplus of the member bank. As a member bank's capital and surplus change, its holdings of the Reserve Bank's stock must be adjusted. Member banks are those state-chartered banks that apply and are approved for membership in the System and all national banks. Currently, only one-half of the subscription is paid-in and the remainder is subject to call. These shares are nonvoting with a par value of $100. They may not be transferred or hypothecated. By law, each member bank is entitled to receive an annual dividend of 6% on the paid-in capital stock. This cumulative dividend is paid semiannually. A member bank is liable for Reserve Bank liabilities up to twice the par value of stock subscribed by it.

Surplus
The Board of Governors requires Reserve Banks to maintain a surplus equal to the amount of capital paid-in as of December 31. This amount is intended to provide additional capital and reduce the possibility that the Reserve Banks would be required to call on member banks for additional capital. Reserve Banks are required by the Board of Governors to transfer to the U.S. Treasury excess earnings, after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in.

The Omnibus Budget Reconciliation Act of 1993 (Public Law 103-66, Section 3002) codified the existing Board surplus policies as statutory surplus transfers, rather than as payments of interest on Federal Reserve notes, for federal government fiscal years 1998 and 1997 (which ended on September 30, 1998 and 1997, respectively). In addition, the legislation directed the Reserve Banks to transfer to the U.S. Treasury additional surplus funds of $107 million and $106 million during fiscal years 1998 and 1997, respectively. Reserve Banks were not permitted to replenish surplus for these amounts during this time. Payments to the U.S. Treasury made after September 30, 1998, represent payment of interest on Federal Reserve notes outstanding.

The Consolidated Appropriations Act of 1999 (Public Law 106-113, Section 302) directed the Reserve Banks to transfer to the U.S Treasury additional surplus funds of $3,752 million during the Federal Government's 2000 fiscal year. The Reserve Banks will make this payment prior to the Federal Government's 2000 fiscal year. The Reserve Banks will make this payment prior to September 30, 2000.

In the event of losses, payments to the U.S. Treasury are suspended until such losses are recovered through subsequent earnings. Weekly payments to the U.S. Treasury may vary significantly.

Income and Cost related to Treasury Services
The Bank is required by the Federal Reserve Act to serve as fiscal agent and depository of the United States. By statute, the Department of the Treasury is permitted, but not required, to pay for these services. The costs of providing fiscal agency and depository services to the Treasury Department that have been billed but will not be paid are reported as the "Cost of unreimbursed Treasury services."

Taxes
The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property, which are reported as a component of "Occupancy expense."

4. **U.S. Government and Federal Agency Securities**

Securities bought outright and held under agreements to resell are held in the SOMA at the FRBNY. An undivided interest in SOMA activity, with the exception of securities held under agreements to resell and the related premiums, discounts and income, is allocated to each Reserve Bank on a percentage basis derived from an annual settlement of interdistrict clearings. The settlement, performed in April of each year, equalizes Reserve Bank gold certificate holdings to Federal Reserve notes outstanding. The Bank's allocated share of SOMA balances was approximately 10.752% and 12.589% at December 31, 1999 and 1998, respectively.

The Bank's allocated share of securities held in the SOMA at December 31, that were bought outright, were as follows (in millions):

	1999	**1998**
Par value :		
Federal agency	$ 19	$ 42
U.S. government		
Bills	18,979	24,519
Notes	23,489	23,654
Bonds	8,922	8,746
Total par value	51,409	56,961
Unamortized premiums	978	930
Unaccreted discounts	(359)	(403)
Total allocated to Bank	$ 52,028	$ 57,488

Total SOMA securities bought outright were $483,902 million and $456,667 million at December 31, 1999 and 1998, respectively.

The maturities of U.S. government and federal agency securities bought outright, which were allocated to the Bank at December 31, 1999, were as follows (in millions):

	Par Value		
Maturities of Securities Held	**U.S. Government Securities**	**Federal Agency Obligations**	**Total**
Within 15 days	$ 498	$ -	$ 498
16 days to 90 days	9,883	3	9,886
91 days to 1 year	15,038	2	15,040
Over 1 year to 5 years	13,351	1	13,352
Over 5 years to 10 years	5,495	13	5,508
Over 10 years	7,125	-	7,125
Total	$ 51,390	$ 19	$ 51,409

At December 31, 1999 and 1998, matched sale-purchase transactions involving U.S. government securities with par values of $39,182 million and $20,927 million, respectively, were outstanding, of which $4,213 million and $2,634 million were allocated to the Bank. Matched sale-purchase of which $4,213 million and $2,634 million were allocated to the Bank. Matched sale-purchase transactions are generally overnight arrangements.

At December 31, 1998, U.S. government securities with par value of $35 million were loaned by the Bank.

5. **Investments Denominated in Foreign Currencies**

The FRBNY, on behalf of the Reserve Banks, holds foreign currency deposits with foreign central banks and the Bank for International Settlements and invests in foreign government debt instruments. Foreign government debt instruments held include both securities bought outright and securities held under agreements to resell. These investments are guaranteed as to principal and interest by the foreign governments.

Each Reserve Bank is allocated a share of foreign-currency-denominated assets, the related interest income, and realized and unrealized foreign currency gains and losses, with the exception of unrealized gains and losses on F/X swaps and warehousing transactions. This allocation is based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31. The Bank's allocated share of investments denominated in foreign currencies was approximately 16.324% and 18.064% at December 31, 1999 and 1998, respectively.

The Bank's allocated share of investments denominated in foreign currencies, valued at current exchange rates at December 31, were as follows (in millions):

	1999	**1998**
German Marks		
Foreign currency deposits	$ -	$ 1,888
Government debt instruments including agreements to resell	-	429
European Union Euro:		
Foreign currency deposits	707	-
Government debt instruments including agreements to resell	414	-
Japanese Yen		
Foreign currency deposits	53	120
Government debt instruments including agreements to resell	1,453	1,119
Accrued interest	8	18
Total	$ 2,635	$ 3,574

Total investments denominated in foreign currencies were $16,140 million and $19,769 million at December 31, 1999 and 1998, respectively.

The 1998 balance includes $15 million in unearned interest collected on certain foreign currency holdings that is allocated solely to the FRBNY.

The maturities of investments denominated in foreign currencies which were allocated to the Bank at December 31, 1999, were as follows (in millions):

Maturities of Investments Denominated in Foreign Currencies	
Within 1 year	$ 2,460
Over 1 year to 5 years	81
Over 5 years to 10 years	94
Over 10 years	-
Total	$ 2,635

At December 31, 1999 and 1998, there were no open foreign exchange contracts or outstanding F/X swaps.

At December 31, 1999 and 1998, the warehousing facility was $5,000 million with nothing outstanding.

6. **Bank Premises and Equipment**

A summary of bank premises and equipment at December 31 is as follows (in millions):

	1999	1998
Bank premises and equipment		
Land	$ 23	$ 23
Buildings	163	154
Building machinery and equipment	37	35
Construction in progress	3	5
Furniture and equipment	135	133
	361	350
Accumulated depreciation	(140)	(131)
Bank premises and equipment, net	$ 221	$ 219

Depreciation expense was $19 million and $17 million for the years ended December 31, 1999 and 1998, respectively.

The Bank leases unused space to outside tenants. Those leases have terms ranging from 1 to 8 years. Rental income from such leases was $1 million for each year ended December 31, 1999 and 1998. Future minimum lease payments under agreements in existence at December 31, 1999, were (in millions):

2000	$ 1.0
2001	1.0
2002	0.9
2003	1.0
2004	0.2
Thereafter	0.4
	$ 4.5

7. **Commitments and Contingencies**

At December 31, 1999, the Bank was obligated under non-cancelable leases for premises and equipment with terms ranging from 1 to approximately 3 years. These leases provide for increased rentals based upon increases in real estate taxes, operating costs or selected price indices.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance and maintenance when included in rent), net of sublease rentals, was $738 thousand and $589 thousand for the years ended December 31, 1999 and 1998, respectively. Certain of the Bank's leases have options to renew.

Future minimum rental payments under non-cancelable operating leases and capital leases, net of sublease rentals, with terms of one year or more, at December 31, 1999, were not material.

Under the Insurance Agreement of the Federal Reserve Banks dated as of March 2, 1999, each of the Reserve Banks has agreed to bear, on a per incident basis, a pro rata share of losses in excess of 1% of the capital paid-in of the claiming Reserve Bank, up to 50% of the total capital paid-in of all Reserve Banks. Losses are borne in the ratio that a Reserve Bank's capital paid-in bears to the total capital paid-in of all Reserve Banks at the beginning of the calendar year in which the loss is shared. No claims were outstanding under such agreement at December 31, 1999 or 1998.

The Bank is involved in certain legal actions and claims arising in the ordinary course of business. Although it is difficult to predict the ultimate outcome of these actions, in management's opinion, based on discussions with counsel, the aforementioned litigation and claims will be resolved without material adverse effect on the financial position or results of operations of the Bank.

8. **Retirement and Thrift Plans**

Retirement Plans

The Bank currently offers two defined benefit retirement plans to its employees, based on length of service and level of compensation. Substantially all of the Bank's employees participate in the Retirement Plan for Employees of the Federal Reserve System ("System Plan") and the Benefit Equalization Retirement Plan ("BEP"). The System Plan is a multi-employer plan with contributions fully funded by participating employers. No separate accounting is maintained of assets contributed by the participating employers. The Bank's projected benefit obligation and net pension costs for the BEP at December 31, 1999 and 1998, and for the years then ended, are not material.

Thrift Plan

Employees of the Bank may also participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System ("Thrift Plan"). The Bank's Thrift Plan contributions totaled $5 million for each year ended December 31, 1999 and 1998, and are reported as a component of "Salaries and other benefits."

9. **Postretirement Benefits Other Than Pensions and Postemployment Benefits**

Postretirement benefits other than pensions

In addition to the Bank's retirement plans, employees who have met certain age and length of service requirements are eligible for both medical benefits and life insurance coverage during retirement.

The Bank funds benefits payable under the medical and life insurance plans as due and, accordingly, has no plan assets. Net postretirement benefit cost is actuarially determined using a January 1 measurement date.

Following is a reconciliation of beginning and ending balances of the benefit obligation (in millions):

	1999	**1998**
Accumulated postretirement benefit obligation at January 1	$ 33.1	$ 32.1
Service cost - benefits earned during the period	0.8	0.7
Interest cost of accumulated benefit obligation	1.9	2.0
Actuarial gain	(5.0)	(0.3)
Contributions by plan participants	0.2	0.2
Benefits paid	(1.2)	(1.6)
Accumulated postretirement benefit obligation at December 31	$ 29.8	$ 33.1

Following is a reconciliation of the beginning and ending balance of the plan assets, the unfunded postretirement benefit obligation, and the accrued postretirement benefit cost (in millions):

	1999	**1998**
Fair value of plan assets at January 1	$ -	$ -
Actual return on plan assets	-	-
Contributions by the employer	1.0	1.4
Contributions by plan participants	0.2	0.2
Benefits paid	(1.2)	(1.6)
Fair value of plan assets at December 31	$ -	$ -
Unfunded postretirement benefit obligation	$ 29.8	$ 33.1
Unrecognized prior service cost	14.3	15.9
Unrecognized net actuarial gain	15.7	11.1
Accrued postretirement benefit cost	$ 59.8	$ 60.1

Accrued postretirement benefit cost is reported as a component of "Accrued benefit cost."

The weighted-average assumption used in developing the postretirement benefit obligation as of December 31, 1999 and 1998, was 7.5% and 6.25%, respectively.

For measurement purposes, an 8.75% annual rate of increase in the cost of covered health care benefits was assumed for 2000. Ultimately, the health care cost trend rate is expected to decrease gradually to 5.50% by 2006, and remain at that level thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one percentage point change in assumed health care cost trend rates would have the following effects for the year ended December 31, 1999 (in millions):

	1 Percentage Point Increase	1 Percentage Point Decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit cost	$ 0.2	$ (0.2)
Effect on accumulated postretirement benefit obligation	1.9	(1.8)

The following is a summary of the components of net periodic postretirement benefit cost for the years ended December 31 (in millions):

	1999	1998
Service cost-benefits earned during the period	$ 0.8	$ 0.6
Interest cost of accumulated benefit obligation	1.9	2.0
Amortization of prior service cost	(1.6)	(1.6)
Recognized net actuarial gain	(0.5)	(0.6)
Net periodic postretirement benefit cost	$ 0.6	$ 0.4

Net periodic postretirement benefit cost is reported as a component of "Salaries and other benefits."

Postemployment benefits

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined and include the cost of medical and dental insurance, survivor income, and disability benefits. Costs were projected using the same discount rate and health care trend rates as were used for projecting postretirement costs. The accrued postemployment benefit costs recognized by the Bank at December 31, 1999 and 1998, were $10 million and $9 million, respectively. This cost is included as a component of "Accrued benefit cost." Net periodic postemployment benefit costs included in 1999 and 1998 operating expenses were $2 million for each year.

The Federal Reserve Bank of San Francisco

ABOUT THE FED

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Federal Reserve Bank of San Francisco
PERSPECTIVES ON A CENTURY OF CHANGE

twelfth federal reserve district

The Federal Reserve Bank of San Francisco is one of 12 regional Reserve Banks which, together with the Board of Governors in Washington, D.C., comprise the nation's central bank.

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As the nation's central bank, the Federal Reserve is responsible for making and carrying out our nation's monetary policy. It also is a bank regulatory agency, a pro-vider of wholesale priced banking services, and the fiscal agent for the United States Treasury.

The Federal Reserve Bank of San Francisco serves the Twelfth Federal Reserve District, which includes the nine western states -- Alaska, Arizona, California, Hawaii, Idaho, Nevada, Oregon, Utah, and Washington -- Guam, American Samoa, and the Northern Mariana Islands.

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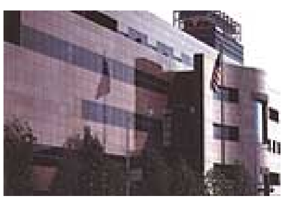
To serve this expansive region, the San Francisco Reserve Bank has five offices: our headquarters in San Francisco and offices in Los Angeles, Portland, Salt Lake City, and Seattle. Each office provides financial services to the banking institutions in its locale.



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