The Federal Reserve Bank of San Francisco

1996 Annual Report

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.

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 provider 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.

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

This Report was written and produced by Karen Flamme. Design and illustrations were created by Mark Hendricks. Layout was completed by L. Dylan Frederick (dylan66@juno.com). Color photography by Paul Schultz (somafoto@msn.com). Textile by Brenda Cooper (cooper1957@aol.com).
This Report takes a look at one of the innovative ways we are using to serve our customers. We in the Twelfth Federal Reserve District have always felt a special challenge in finding efficient ways to serve constituents spread over 1.3 million square miles, 35 percent of the nation’s area. In addition to covering these vast geographical expanses, we enjoy a diverse client base which ranges from rural to urban locations, small to large institutions, with varying needs and opportunities for interaction with the Federal Reserve. The World Wide Web gives us yet another vehicle for interacting with and providing timely information to many of these people. It is a medium which lets us, and our customers, react quickly to changing events. The site can be continually evolving and changing, making it a more dynamic medium than traditional publishing.

In a District as large and varied as this, we place a strong reliance on the input of our directors to keep us in tune with their areas and industries as we perform the important tasks of formulating monetary policy and managing the nation’s financial system. We would like to thank all Twelfth District directors for their invaluable counsel and assessments of economic and financial conditions throughout the West during 1996.

We want to express our sincere thanks and appreciation to those directors who completed their terms of service during 1996: on the San Francisco Head Office Board, 1996 Deputy Chairman and immediate past Chairman of the Board, James A. Vohs (Chairman, Retired, Kaiser Foundation Health Plan, Inc., and Kaiser Foundation Hospitals, Oakland, CA), and Richard L. Mount (Chairman, President and CEO, Saratoga Bancorp, Saratoga, CA); on the Los Angeles Branch Board, Chairman, Anita E. Landecker (Western Regional Vice President, Local Initiatives Support Corporation, Los Angeles, CA), William S. Randall (President, Retired, the former First Interstate Bancorp, Los Angeles, CA), and Thomas L. Stevens, Jr. (President, Retired, Los Angeles Trade-Technical College, Los Angeles, CA); on the Portland Branch Board, Chairman, Ross R. Runkel (Professor of Law, Willamette University, Salem, OR), Cecil W. Drinkward (President and CEO, Hoffman Corporation, Portland, OR), Elizabeth (Betsy) K. Johnson (President, TransWestern, Inc., Scappoose, OR), and Marvin R. O’Quinn (Chief Operating Officer, Providence Portland Medical Center, Portland, OR); on the Salt Lake City Branch Board, Constance G. Hogland (Executive Director, Boise Neighborhood Housing Services, Inc., Boise, Idaho); and, on the Seattle Branch Board, Chairman, George F. Russell, Jr. (Chairman, Frank Russell Company, Tacoma, WA), and Thomas E. Cleveland (Chairman and CEO, Access Business Finance, Bellevue, WA). We also note here, with much sadness, the untimely loss in 1996 of a good and gifted friend and counselor, Seattle Branch Director Dr. William R. Wiley (Senior Vice President, Science and Technology Policy, Battelle Memorial Institute, Richland, WA).
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Opening a New Office

By Karen Flamme

"Open 24 Hours!"

It wasn’t long ago that a sign announcing round-the-clock service was a pretty good indication that a business was willing to go to extraordinary measures to meet its customers’ needs. Since then, 24-hour, walk-in service has become commonplace in a number of industries. Today, to keep ahead of, or even abreast of the competition, many businesses are taking a leap into cyberspace and opening virtual offices that are accessible 24 hours a day, 365 days a year, to customers around the world. And the best part is that customers can access these offices from the comfort of their homes, offices, or neighborhood coffeehouses.

In the spring of 1996, the Federal Reserve Bank of San Francisco opened just such an office on the World Wide Web.

Our address -- / -- leads customers to the entrance of the FedWest GateWay, a portal to information from and about the Federal Reserve Bank of San Francisco. It's as accessible to a banker in downtown Los Angeles as it is to a rancher in eastern Oregon, a teacher in Connecticut, or a student in Switzerland.

In educating the public about the Federal Reserve System’s purposes and functions and role as fiscal agent for the United States Treasury, the Web is proving to be an efficient and cost-effective way to reach constituents within our nine-state District and beyond. In an era in which it is increasingly difficult to know who wants and needs information about the economy, the Federal Reserve, and the services we provide, the Web gives us a way to publish various kinds of information quickly and inexpensively and let our customers choose what they need when they need it. It is easily accessible, educational, and engaging, allowing users to receive information nearly instantaneously, explore, select what they want, and communicate with us whenever convenient. In addition, interactive features which let users give us feedback allow us to learn from and about our public.

Information organization is one of the biggest challenges to web site developers. A common complaint about the Internet is that there is so much information available on it that it is difficult for users to find what they need quickly and efficiently. Our clients want to navigate easily to the information they need without becoming snared in a frustrating and time-consuming tangle of information overload.

To avoid the snares and tangles, FedWest GateWay is organized in sections, grouping similar information together with similar usage patterns. Distinct graphics and easy-to-follow menus provide overviews of the contents and guide users to their destinations.

FedWest GateWay is currently arranged into seven sections: Inside the FRBSF, Economic Research, Treasury Securities or Savings Bonds, Economics Education, Banking and Finance in the West, Federal Reserve System, and Community Affairs. Within each of these sections there are subsections which further define the available choices and offer links to other relevant sites. At every point it is easy to retrace your steps, back up to main menus, find out what’s new on the site, access the glossary, perform searches, and give feedback.

Inside the FRBSF - What better than the Golden Gate Bridge and seal of the Twelfth Federal Reserve District to let you know graphically you are entering a world of information about the Federal Reserve Bank of San Francisco? Designed to entice the casual web browser, business person, student, or job seeker, this section is broken into five categories.
Treasury Securities or Savings Bonds - The site's most popular area is introduced by a graphic of stately columns whose clickable buttons lead visitors to information about Treasury Securities or Savings Bonds. As fiscal agent of the United States Treasury, this Bank provides direct sales and service of marketable Treasury securities.

Economic Research - Charts and graphs about the economy visually lead you into the three subsections which comprise Economic Research.

Economics Education - This gate opens onto a blackboard symbolizing resources designed especially for teachers and students.

Banking and Finance in the West - Here a ranch-style gate opens to a banc card symbolizing the growing importance of electronic banking and finance. As the central bank for the geographically largest and most populated district in the Federal Reserve System, the San Francisco Reserve Bank has plenty to keep track of in the way of banking and finance. Feedback features on the Web let us find out our customers' needs and wants and be responsive to them. This helps us fulfill our mission of keeping the nation's payments system operating efficiently and safely. From local banks in Alaskan outposts to multi-branch urban financial institutions, we are committed to providing information and services for and about our customers.

Community Affairs - Among its varied functions, the Federal Reserve produces newsletters, reports, seminars, workshops, and conferences and encourages banks to work with community organizations to promote local economic development.

Federal Reserve System - Basic information about what the Federal Reserve System is and what it does, as well as other governmental resources, can be found at this location on the site.

By the time you exit FedWest GateWay -- our virtual office -- we trust you will feel your visit was rewarding. We hope that you found the information you came for; learned something new; communicated with us; were entertained; and will visit us at this office again soon -- remember, it's open 24 hours.

It's only fitting that giving good customer service in the West would include using the most advanced technology, and the entire Twelfth District is sure to benefit from currently emerging technologies. According to a recent study by the Bay Area Economic Forum, "The San Francisco Bay Area is clearly at the cutting edge of the emerging knowledge-based economy in the U.S. It leads all other regions in key indicators: the largest share of college and advanced degrees; more and better research centers; more than double the average number of patents per employee; the largest share of high tech exports; and three times the commercial Internet domains.

"There are also many exciting new Internet companies," the report continues. "One company is pioneering methods for conducting cash transactions over the Internet in a secure way, and another is working with the larger banks to develop standards for bank payments over the Internet.

"The Bay Area is also the birthplace of many of the fastest growing financial services companies in the U.S. . . . due in part to the fact that unprecedented links have been formed between the traditional banking community and the region's cutting-edge information and computing services companies. The close proximity between the Bay Area's financial institutions and information technology companies promotes partnering and cross-industry learning."

The Bay Area: Leading the Transition to a Knowledge-Based Economy Published by the Bay Area Economic Forum, August 1996 http://netra1.abag.ca.gov/bayarea/commerce/baef.html
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Executive Committee, Officers, and Branch Operations

- Executive Committee
- Bank Officers
- Branch Officers

- Los Angeles Branch
- Northern Region
- Portland Branch
- Salt Lake City Branch
- Seattle Branch

- Branch Operations

Executive Committee

From left, Elizabeth K. Christensen, Senior Vice President; John F. Moore, First Vice President and Chief Operating Officer; Robert T. Parry, President and Chief Executive Officer; Jack H. Beebe, Senior Vice President and Director of Research; Terry S. Schwakopf, Senior Vice President; and Gordon R. G. Werkema, Executive Vice President.

Bank Officers

As of December 31, 1996

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

Elizabeth K. Christensen
Senior Vice President

Sara K. Garrison
Senior Vice President

Michael J. Murray
Senior Vice President

Terry S. Schwakopf
Senior Vice President

Laurence Washtien
Senior Vice President

D. Kerry Webb
Senior Vice President

S. Jean Hinrichs
General Auditor

Robert D. Mulford
Vice President, General Counsel

Susan A. Sutherland
Director

Kenneth M. Kinoshita
Associate General Counsel

Beatrice K. Ashburn
Assistant Vice President

Paige Birdsall
Assistant Vice President

Sylvia A. Cunningham
Assistant Vice President

Gail A. Garvey
Assistant Vice President

Elaine Geller
Assistant Vice President

Todd Glissman
Assistant Vice President

John S. Hsiao
Assistant Vice President

Peter K. C. Hsieh
Assistant Vice President

Deborah S. Jackson-Duke
Assistant Vice President

Lelia M. Jones
Assistant Vice President

Craig B. Knudsen
and Ethics Officer
Elizabeth R. Masten
Vice President and Secretary of the Board
Barbara J. Contini
Vice President
Frederick T. Furlong
Vice President
William K. Ginter
Vice President
Reuven Glick
Vice President
John P. Judd
Vice President and Associate Director of Research
Ronald E. Mitchell, Jr.
Vice President
Susan Porterfield
Vice President
Douglas R. Shaw
Vice President and Counsel
W. Gordon Smith
Vice President
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
Nancy Emerson
Director
Eliot E. Giuili
Director
Donald R. Lieb
Director
John Y. C. Lin
Director
Craig B. Knudsen
Assistant Vice President
Ellsworth E. Lund, Jr.
Assistant Vice President
Bonnie R. Allen
Assistant Vice President
Elizabeth M. O'Shea
Assistant Vice President
Philip M. Ryan
Assistant Vice President
W. Starr Seegmiller
Assistant Vice President
James J. Tenge
Assistant Vice President
Thomas R. Thaanum
Assistant Vice President
David W. Walker
Assistant Vice President
Jim Callahan
Audit Officer
Angela D'Alessandro
Examining Officer
Louis "Skip" George
District Security Officer
Beverley Ann Hawkins
Automation Resources Officer
Michael E. Johnson
Applications Officer
Mark Levonian
Research Officer
Joy Hoffmann Molloy
Community Affairs Officer
Brian Motley
Research Officer
Gary P. Palmer
Financial Analysis Officer
Darren S. Post
Officer, ACH, Business Development and Electronic Product Support
Glenn D. Rudebusch
Research Officer
Bharat Trehan
Research Officer
Elizabeth L. Wood
Systems Officer

Branch Officers

Los Angeles Branch
Mark Mullinix
Senior Vice President
Sean J. Rodriguez
Vice President and Assistant Branch Manager
Darcy J. Coulter
Director
Nancy Olmstead
Director
Robert C. Johnson
Assistant Vice President
Roger W. Replogle
Assistant Vice President
Rachel A. Romero
Assistant Vice President
Dale L. Vaughan
Assistant Vice President
Marla E. Borowski
fficers.html
Northern Region

Gordon Werkema
Executive Vice President

Portland
Raymond H. Laurence
Senior Vice President
Mary E. Lee
Assistant Vice President
Robert D. Long
Assistant Vice President
Robin A. Rockwood
Assistant Vice President

Salt Lake City
Andrea P. Wolcott
Vice President
Jed W. Bodily
Assistant Vice President
Gerald R. Dalling
Assistant Vice President
Richard B. Hornsby
Assistant Vice President
Thomas P. McGrath
Assistant Vice President

Seattle
Gale P. Ansell
Assistant Vice President
Jimmy F. Kamada
Assistant Vice President
Kenneth L. Peterson
Assistant Vice President
Michael J. Stan
Assistant Vice President

Branch Operations

From left, Mark Mullinix, Senior Vice President, Los Angeles; Andrea P. Wolcott, Vice President, Salt Lake City; Gordon R. G. Werkema, Executive Vice President, Northern Region; and Raymond H. Laurence, Senior Vice President, Portland.
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Highlights of 1996

Keeping the nation's payments system operating smoothly and efficiently continues to be a challenge to the regional Reserve Banks as the needs of our customers change and expand rapidly. We are developing new technologies and customized solutions to creatively tailor the banking services we offer to depository institutions and the federal government. There were several notable milestones in 1996.

It's our job to make sure there is enough coin and currency in circulation to meet the public's demand. In fact, the warehousing, shipping, processing, and handling of currency are major functions of the Reserve Banks. This was an especially notable challenge in 1996 as we introduced the redesigned $100 bill to the public in March. The redesigned bills include new or modified features to improve security and stay ahead of counterfeiters and advances in technology which make it easier to reproduce currency. A seamless introduction of the new currency into the money stream was essential.

We began storing the new notes at all of our five offices as early as January to make sure we had enough on hand to release the end of March. But before that, in the third quarter of 1995, we held 20 customer education seminars in seven states throughout the Twelfth District. In addition to the seminars, we distributed information kits; circulated an informational video with reasons for the redesign, circulation plans, and recognizable features of the redesigned currency; and staffed an information desk to assist customers with any questions regarding the new currency.

To facilitate the smooth rollover of $100s in foreign markets, Extended Custodial Inventories (ECIs) were established and managed by the Federal Reserve Bank of New York in London, Frankfurt, and Zurich. These ECIs strategically stockpiled inventories in key markets and geographic redistribution centers to minimize inventory limitations imposed by flight schedules and in-transit insurance ceilings.

Were we successful? Currently, approximately 60 percent of all $100s flowing back to our Bank are the newly designed notes, and they now make up 32.7 percent of the 2.6 billion notes in circulation.

But all transactions are not handled in cash. In fact, check volume, contrary to forecasters' predictions, continues to increase, and handling paper checks and the related movement of funds remain costly and labor intensive. Approximately 63 billion checks are written each year in the United States, a number which is expected to continue to grow over the next several years.

Converting these paper checks to electronic data is one way to expedite check clearing. Electronic Check Presentment (ECP), for example, provides financial institutions with an electronic file of check data in advance of the delivery of the physical checks from the Federal Reserve, allowing earlier identification of fraud, decreased clearing times, and reduced reliance on transportation.

During 1996, the Bank introduced check imaging as a complement to such electronic products as ECP. Check imaging takes a digital picture of a check and saves it in digital, computer-file form for retrieval when needed. This process, in essence, turns a paper check into an electronic "picture" which is easier to organize, distribute, store, and access. ECP, together with check images, allows banks and their cash management customers to address fraud and risk concerns up to 12 hours earlier than if they had to wait for the arrival of physical checks. Retrieving check images from computer storage systems also speeds response time in handling customer balance inquiries, requests for check clearing information, and requests for check copies, resulting in operational efficiencies and improved customer service. The Bank's check image product line is flexible and can be easily customized to meet a variety of needs.

Electronic funds transfer is a faster and more secure method of payment than either cash or check. The automated clearing house (ACH) is an electronic funds transfer system. This nationwide network processes electronically originated credit and debit transfers such as direct deposit payroll payments and corporate payments to contractors and vendors. During 1996 the Federal Reserve System converted to a new centralized ACH application software, Fed ACH. This software enabled us to significantly reduce fees and provide depository institutions with greater control over how they access, process, and settle ACH transactions. Because ACH transactions are processed from one central computer site within the Federal Reserve System, items no longer have to be transmitted from one Federal Reserve district to another.

In addition, customers have expanded file delivery options and enhanced on-line access. This means they can have greater processing flexibility and provide their customers with time-critical ACH payments more quickly.

The Federal Reserve also holds U.S. government securities in safekeeping as book entries--electronic records rather than paper certificates--for depository institutions. During 1996, the Federal Reserve Bank of San Francisco also installed new software in this service. This software, which is referred to as NBES (New Book-Entry System), provides for centralized computer processing at a single site with standardized services to depository institutions. NBES offers an increased number of accounts available to users; improved contingency and disaster recovery capabilities; quick wire transfers for all transactions; and enhanced reporting features.

Operational controls in the Los Angeles Branch Cash area received an unusual amount of scrutiny in 1996. As a result of an internal compliance team's findings of errors in a Los Angeles Cash administrative report, the General Accounting Office reviewed the department's statistical reporting processes and noted possible concerns regarding the integrity of cash accounting and financial controls. By year-end, results of an internal audit, a Board of Governors examination, an unannounced vault
count, and an independent, external accounting firm’s review all pointed to the soundness of our operational controls and the integrity of our overall cash operation.

**Economic Research**

Research during 1996 addressed policy-related issues, including U.S. monetary policy, international topics, and the effects of banking industry restructuring. Staff published extensively both in Bank publications and outside academic journals.

Monetary policy studies covered such topics as the effect of policy on the economy, indicators of future inflation, and the way in which the Fed sets the stance of monetary policy in response to economic developments. International topics included monetary policy targets in the United Kingdom, New Zealand, and Japan; exchange rate risk and trade flows; and exchange rate exposure and crises. Banking studies looked at efficiency, the pricing of financial services, and the availability of credit. This research formed the basis for extensive briefings of senior management on monetary and regulatory policy, as well as economic developments in the western United States and the Pacific Basin.

Furthering the Bank’s ongoing efforts to promote cooperation and share research among Pacific Basin countries, our Center for Pacific Basin Monetary and Economic Studies held a conference, "Managing Capital Flows and Exchange Rates: Lessons from the Pacific Basin.” The department also co-hosted an academic conference with the Center for Economic Policy Research at Stanford University. Papers at that conference examined the measurement and management of monetary policy.

**Banking Supervision and Regulation**

The supervision and regulation function in 1996 was significantly affected by rapid changes in the industry brought on by increased industry consolidation, interstate branching and banking, and the development of electronic banking products and services. Specific emphasis was placed on risk management, concentrating on increasing the value of the supervisory process and ensuring its efficiency and effectiveness for our customers.

To achieve delivery of a more effective, risk-focused, and seamless supervisory approach, the Consumer Compliance and Community Affairs and Bank Supervision and Regulation departments were merged into one division.

At year-end there were 62 state member banks in the District. There were also 210 holding companies with assets totaling $522 billion, 120 branches and agencies of foreign banks, 8 Edge and Agreement corporation offices, and 40 representative offices.

Overall applications activity declined as the total number of applications filed during 1996 reached 291 as compared to 310 in 1995. This level, while slightly reduced from the prior year’s activity, continues to reflect the expansion and consolidation of the industry. Applications to form bank holding companies declined from 54 during 1995 to 26 in 1996, and merger applications by state member banks declined by half in 1996.

The Twelfth District continued to provide guidance and direction on community reinvestment throughout the nine Western states. Community Affairs co-sponsored, with the American Bankers’ Association and the Small Business Administration, the 1996 National Community Development Lending Conference. Later in the year, the unit sponsored its annual Community Reinvestment conference, entitled “The New CRA: Focus on the Future.” It also sponsored two one-day small business lending conferences and a conference on electronic banking and its implications for consumers, and facilitated numerous other meetings. Staff also coordinated a series of seven public meetings on the proposed merger between First Interstate Bank of California and Wells Fargo Bank, with approximately 550 individuals providing their comments on CRA activity of these banks.

In the area of community development, the Bank provided leadership to the Association of Reinvestment Consortia for Housing, and consulted with Seattle-based banks on the formation of the Seattle Small Business Lenders Association’s “One Stop Capital Shop.” To assist banks in identifying local investment opportunities, the unit held bi-monthly roundtables in Boise, Las Vegas, Los Angeles, Salt Lake City, San Francisco, and Seattle.
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1996 Annual Report
Summary of Operations

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<tr>
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<tbody>
<tr>
<td><strong>Custody Services</strong></td>
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<tr>
<td>Cash Services</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Currency notes paid into circulation</td>
<td>4,212,494</td>
<td>4,298,035</td>
<td>4,317,704</td>
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<tr>
<td>Food stamp coupons processed</td>
<td>694,306</td>
<td>753,589</td>
<td>748,535</td>
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<tr>
<td><strong>Securities Services</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Treasury original issues</td>
<td>216</td>
<td>201</td>
<td>125</td>
</tr>
<tr>
<td>Book-entry securities processed</td>
<td>805</td>
<td>894</td>
<td>829</td>
</tr>
<tr>
<td><strong>Payments Services</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Check Services</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commercial checks collected</td>
<td>2,269,690</td>
<td>2,082,513</td>
<td>2,188,856</td>
</tr>
<tr>
<td>Government checks processed</td>
<td>69,567</td>
<td>67,148</td>
<td>61,741</td>
</tr>
<tr>
<td>Return items processed</td>
<td>29,941</td>
<td>30,569</td>
<td>32,767</td>
</tr>
<tr>
<td>Electronic Payments Services</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wire transfers processed</td>
<td>19,507</td>
<td>20,146</td>
<td>22,113</td>
</tr>
<tr>
<td>Automated clearinghouse transactions processed</td>
<td>459,032</td>
<td>525,549</td>
<td>404,974</td>
</tr>
<tr>
<td><strong>Discounts and Advances</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total discounts and advances*</td>
<td>587</td>
<td>482</td>
<td>461</td>
</tr>
<tr>
<td>Number of financial institutions accommodated*</td>
<td>56</td>
<td>66</td>
<td>83</td>
</tr>
</tbody>
</table>

*Whole number (not in thousands)
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Statement of Condition

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Gold certificates</td>
<td>$ 1,067</td>
<td>$ 1,036</td>
</tr>
<tr>
<td>Special drawing rights certificates</td>
<td>957</td>
<td>977</td>
</tr>
<tr>
<td>Coin</td>
<td>74</td>
<td>37</td>
</tr>
<tr>
<td>Items in process of collection</td>
<td>1,873</td>
<td>574</td>
</tr>
<tr>
<td>Loans to depository institutions</td>
<td>15</td>
<td>103</td>
</tr>
<tr>
<td>U.S. government and federal agency securities, net</td>
<td>33,393</td>
<td>30,308</td>
</tr>
<tr>
<td>Investments denominated in foreign currencies</td>
<td>2,631</td>
<td>2,935</td>
</tr>
<tr>
<td>Accrued interest receivable</td>
<td>301</td>
<td>308</td>
</tr>
<tr>
<td>Interdistrict settlement account</td>
<td>23,441</td>
<td>5,351</td>
</tr>
<tr>
<td>Bank premises and equipment, net</td>
<td>220</td>
<td>206</td>
</tr>
<tr>
<td>Other assets</td>
<td>23</td>
<td>26</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>$ 63,995</strong></td>
<td><strong>$ 41,861</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities and Capital</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Liabilities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Federal Reserve notes outstanding, net</td>
<td>$ 56,905</td>
<td>$ 35,901</td>
</tr>
<tr>
<td>Deposits:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depository institutions</td>
<td>3,612</td>
<td>4,188</td>
</tr>
<tr>
<td>Other deposits</td>
<td>22</td>
<td>20</td>
</tr>
<tr>
<td>Deferred credit items</td>
<td>1,575</td>
<td>533</td>
</tr>
<tr>
<td>Statutory surplus transfer</td>
<td></td>
<td></td>
</tr>
<tr>
<td>due U.S. Treasury</td>
<td>49</td>
<td>0</td>
</tr>
<tr>
<td>Interest on Federal Reserve notes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>due U.S. Treasury</td>
<td>0</td>
<td>54</td>
</tr>
<tr>
<td>Accrued benefit cost</td>
<td>70</td>
<td>69</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>17</td>
<td>12</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td><strong>62,250</strong></td>
<td><strong>40,777</strong></td>
</tr>
</tbody>
</table>

| **Capital:**                                |               |               |
| Capital paid-in                             | 880           | 542           |
| Surplus                                     | 865           | 542           |
| **Total capital**                           | **1,745**     | **1,084**     |
| **Total liabilities and capital**           | **$ 63,995**  | **$ 41,861**  |

The accompanying notes are an integral part of these financial statements.
### The Federal Reserve Bank of San Francisco

**1996 Annual Report**

**Statement of Income**

<table>
<thead>
<tr>
<th>(in millions)</th>
<th>for the years ended</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Interest income:</strong></td>
<td></td>
</tr>
<tr>
<td>Interest on U.S. government securities</td>
<td>$1,967</td>
</tr>
<tr>
<td>Interest on foreign currencies</td>
<td>61</td>
</tr>
<tr>
<td>Interest on loans to depository institutions</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total interest income</strong></td>
<td><strong>2,029</strong></td>
</tr>
<tr>
<td><strong>Other operating income:</strong></td>
<td></td>
</tr>
<tr>
<td>Income from services</td>
<td>82</td>
</tr>
<tr>
<td>Reimbursable services to government agencies</td>
<td>18</td>
</tr>
<tr>
<td>Foreign currency gains (losses), net</td>
<td>(228)</td>
</tr>
<tr>
<td>Government securities gains, net</td>
<td>3</td>
</tr>
<tr>
<td>Other income</td>
<td>3</td>
</tr>
<tr>
<td><strong>Total other operating income (loss)</strong></td>
<td><strong>(122)</strong></td>
</tr>
<tr>
<td><strong>Operating expenses:</strong></td>
<td></td>
</tr>
<tr>
<td>Salaries and other benefits</td>
<td>143</td>
</tr>
<tr>
<td>Occupancy expense</td>
<td>16</td>
</tr>
<tr>
<td>Equipment expense</td>
<td>19</td>
</tr>
<tr>
<td>Cost of unreimbursed Treasury services</td>
<td>5</td>
</tr>
<tr>
<td>Assessments by Board of Governors</td>
<td>58</td>
</tr>
<tr>
<td>Other expenses</td>
<td>67</td>
</tr>
<tr>
<td><strong>Total operating expenses</strong></td>
<td><strong>308</strong></td>
</tr>
<tr>
<td><strong>Income before cumulative effect of accounting change</strong></td>
<td>1,599</td>
</tr>
<tr>
<td><strong>Cumulative effect of change in accounting principle</strong></td>
<td>0</td>
</tr>
<tr>
<td><strong>Net income prior to distribution</strong></td>
<td><strong>$1,599</strong></td>
</tr>
<tr>
<td><strong>Distribution of net income:</strong></td>
<td></td>
</tr>
<tr>
<td>Dividends paid to member banks</td>
<td>$41</td>
</tr>
<tr>
<td>Transferred to surplus</td>
<td>338</td>
</tr>
<tr>
<td>Payments to U.S. Treasury as interest on Federal Reserve notes</td>
<td>852</td>
</tr>
<tr>
<td>Payments to U.S. Treasury as required by statute</td>
<td>368</td>
</tr>
</tbody>
</table>
### Statement of Changes in Capital

For the years ended December 31, 1996 and December 31, 1995

<table>
<thead>
<tr>
<th></th>
<th>Capital Paid-in</th>
<th>Surplus</th>
<th>Total Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance at January 1, 1995</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(10,244,349 shares)</td>
<td>$ 512</td>
<td>$ 512</td>
<td>$ 1,024</td>
</tr>
<tr>
<td>Net income transferred to surplus</td>
<td></td>
<td>30</td>
<td></td>
</tr>
<tr>
<td>Net change in capital stock issued (588,751 shares)</td>
<td></td>
<td>$ 30</td>
<td>$ 30</td>
</tr>
<tr>
<td><strong>Balance at December 31, 1995</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(10,833,100 shares)</td>
<td>$ 542</td>
<td>$ 542</td>
<td>$ 1,084</td>
</tr>
<tr>
<td>Net income transferred to surplus</td>
<td></td>
<td>338</td>
<td></td>
</tr>
<tr>
<td>Statutory surplus transfer to the U.S. Treasury (15)</td>
<td>(15)</td>
<td>(15)</td>
<td></td>
</tr>
<tr>
<td>Net change in capital stock issued (6,760,353 shares)</td>
<td></td>
<td>$ 338</td>
<td>$ 338</td>
</tr>
<tr>
<td><strong>Balance at December 31, 1996</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(17,593,453 shares)</td>
<td>$ 880</td>
<td>$ 865</td>
<td>$ 1,745</td>
</tr>
</tbody>
</table>

*The accompanying notes are an integral part of these financial statements.*
1996 Annual Report

Boards of Directors

- San Francisco
- Los Angeles
- Portland
- Salt Lake City
- Seattle

San Francisco Board of Directors

**Chairman and Federal Reserve Agent**
Judith M. Runstad
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Foster, Pepper & Shefelman
Seattle, Washington

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Chief Financial Officer
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Thousand Oaks, California

E. Lynn Caswell
Vice Chairman
Monarch Bancorp
Laguna Hills, California

Warren K. K. Luke
Vice Chairman, President
and CEO
Hawaii National Bank
Honolulu, Hawaii

Stanley T. Skinner
Chairman and CEO
Pacific Gas and Electric Co.
San Francisco, California

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Albertson's Inc.
Boise, Idaho

Gerry B. Cameron
Chairman and CEO
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Portland, Oregon

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President and CEO
Sierra Machinery, Inc.
Sparks, Nevada

Cynthia A. Parker
Executive Director
Anchorage Neighborhood
Housing Services, Inc.
Anchorage, Alaska

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President and COO
Wells Fargo & Company
San Francisco, California

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Anne Ledford Evans
Chairman
Evans Hotels
San Diego, California

Lori R. Gay
President
Los Angeles Neighborhood
Housing Services, Inc.
Los Angeles, California

**Federal Advisory Council Member**
Antonia Hernandez
President and General Counsel
Mexican American Legal Defense and Educational Fund (MALDEF)
Los Angeles, California

**Vacant Position**

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Stephen G. Carpenter
Chairman of the Board
and CEO
California United Bank
Encino, California

David Lewis Moore
President
Western Growers Association
Irvine, California

**Vacant Position**
Portland Branch Board of Directors

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Proprietor
Rocking C Ranch
Elkton, Oregon

Patrick Borunda
Executive Director
Oregon Native American Business & Entrepreneurial Network (ONABEN)
Portland, Oregon

John David Eskildsen
President and CEO
U.S. National Bank of Oregon
Portland, Oregon

Thomas Cook Young
Chairman, President and CEO
Northwest National Bank
Vancouver, Washington

Salt Lake City Branch Board of Directors

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President
Southern Utah University
Cedar City, Utah

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President and CEO
Salt Lake Convention and Visitors Bureau
Salt Lake City, Utah

J. Pat McMurray
President
First Security of Idaho
Boise, Idaho

Roy C. Nelson
President
Bank of Utah
Ogden, Utah

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Chairman and CEO
Puget Sound Energy, Inc.
Bellevue, Washington

Boyd E. Givan
Senior Vice President and CFO
The Boeing Company
Seattle, Washington

Betsy Lawer
Vice Chair and COO
First National Bank of Anchorage
Anchorage, Alaska

Helen M. Rockey
President and CEO
Brooks Sports, Inc.
Bothell, Washington

John V. Rindlaub
Chairman
Seafirst Bank
Seattle, Washington

Constance L. Proctor
Partner
Alston, Courtnage, MacAulay & Proctor
Seattle, Washington

Tomio Moriguchi
Chairman and CEO
Uwajimaya, Inc.
Seattle, Washington
The Federal Reserve Bank of San Francisco

1996 Annual Report

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on Small Business and Agriculture

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Bailey S. Barnard
Allied Capital
San Francisco, California

Vice Chairman
Karla S. Chambers
Vice President
Stahlbush Island Farms, Inc.
Corvallis, Oregon

Members
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President
Willey Motors, Inc.
Bountiful, Utah

Paula R. Collins
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WDG Ventures, Inc.
San Francisco, California

Jerry D. Caulder
Chairman and CEO
Mycogen Corporation
San Diego, California

Walter F. Payne, Jr.
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Blue Diamond Growers
Sacramento, California

Peter H. van Oppen
Chairman and CEO
Advanced Digital Information Corporation
Redmond, Washington

Lawrence S. Okinaga
Partner
Carlsmith Ball Wichman Case & Ichiki
Honolulu, Hawaii

Barry Baszile
President
Baszile Metals Service
Los Angeles, California

Peter H. Parra
Board of Supervisors
Fifth District, County of Kern
Bakersfield, California

Richard S. Walden
President
Farmers Investment Co.
Sahuarita, Arizona

Bob L. Vice
President and CEO
California Farm Bureau Federation
Sacramento, California
1996 Annual Report

Twelfth Federal Reserve District

- San Francisco Office
  P.O. Box 7702
  San Francisco, CA 94120

- Los Angeles Branch
  P.O. Box 2077, Terminal Annex
  Los Angeles, CA 90051

- Portland Branch
  P.O. Box 3436,
  Portland, OR 97208

- Salt Lake City Branch
  P.O. Box 30780
  Salt Lake City, UT 84125

- Seattle Branch
  P.O. Box 3567, Terminal Annex
  Seattle, WA 98124
1996 Annual Report

Notes to Financial Statements

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 Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property.

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 that includes Alaska, 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 chosen partly by nomination and election by member banks and partly by the Board of Governors. 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 Bank boards of directors. 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 clearing house 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.

3. Significant Accounting Policies:

Specialized 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 generally documented in the "Financial Accounting Manual for Federal Reserve Banks" (the "Financial Accounting Manual"), which is published 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 policies of the Reserve Banks and generally accepted accounting principles ("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. Accounting policies and practices for U. S. government and federal agency securities and investments denominated in foreign currencies are further described in note 3(d). In addition, the Bank has elected not to include a Statement of Cash Flows, as the liquidity and cash position of the Bank are not of primary concern to users of these financial statements. 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 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 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.

a. 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 System 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 account is 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.

b. Special Drawing Rights Certificates

Special drawing rights ("SDRs") are issued by the International Monetary Fund ("the 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 S. U. S. Treasury, and the Reserve Banks’ SDR certificate account is 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.

c. 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 method and is charged at the 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 that rate in certain circumstances.

d. U. S. Government and Federal Agency Securities and Investments Denominated in Foreign Currencies

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. 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"). 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 purchases and sales of securities, matched sale-purchase transactions, and the purchase of securities under agreements to resell. These transactions are conducted in U. S. government and federal agency securities. All balances and related income arising from these transactions, other than securities purchased under agreements to resell, are participated, or designated, to each Reserve Bank.

Specifically, the FRBNY provides or absorbs reserve deposits of depository institutions by purchasing or selling government securities, respectively, in the open market. While the application of current market prices to the securities currently held by the Reserve Banks may result in values substantially above or below their carrying values, these unrealized changes in value would have no necessary effect on the quantity of reserves available to the banking system or on the prospects for future Reserve Bank earnings or capital.

Matched sale-purchase transactions are generally overnight transactions in which the FRBNY sells a security and buys it back the next day at the rate specified at the commencement of the transaction. These transactions are accounted for as separate sale and purchase transactions. At December 31, 1996, and December 31, 1995, matched sale-purchase transactions involving U.S. government securities with par values of $15 billion and $12 billion, respectively, were outstanding.

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 and, to the extent possible, invest the resulting balances. The portfolio for each foreign currency shall generally have an average duration of no more than eighteen months. Balances and changes in balances of investments denominated in foreign currencies arise from transactions to counter disorderly conditions in exchange markets and other needs specified by the FOMC in carrying out the System’s central bank responsibilities.

Although the portfolios of U.S. government and federal agency securities and investments denominated in foreign currencies generate interest income and transactions can result in gains or losses when holdings are sold prior to maturity, decisions regarding these securities and investments, 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 securities and investments are incidental to the open market and foreign currency operations and do not motivate activities or policy decisions.

In accordance with the Federal Reserve Act, and as further explained in note 3(g), all domestic securities and investments denominated in foreign currencies held by the Bank are pledged as collateral for net Federal Reserve notes outstanding.

e. 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.
f. 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 and automated clearinghouse ("ACH") clearing operations, and allocations of shared expenses. The cumulative net amount owed from or due to other Reserve Banks is reported as the "Interdistrict settlement account."

g. 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. The 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. To satisfy its obligation to provide sufficient collateral for its outstanding Federal Reserve notes, the Reserve Banks have entered into an agreement that provides that certain assets of the Reserve Banks are jointly pledged as collateral for the Federal Reserve notes of all Reserve Banks. In the event that this collateral is insufficient, the 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 Reserve Banks of $14 billion, and $11 billion at December 31, 1996 and December 31, 1995, respectively.

h. 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 changes, 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.

i. Surplus

The Board of Governors requires Reserve Banks to maintain a surplus equal to the amount of capital paid-in as of December 31 of the prior year. 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. Prior to October 1, 1996, this payment represented payment of interest on Federal Reserve notes outstanding.

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 1997 (which began on October 1, 1996) and 1998. In addition, the legislation directs the Reserve Banks to transfer to the U.S. Treasury additional surplus funds of $106 million and $107 million during fiscal years 1997 and 1998, respectively. Reserve Banks are not permitted to replenish surplus for these amounts during this time. The Reserve Banks transferred $106 million to the U.S. Treasury on October 1, 1996. The Bank transferred $15 million from surplus on October 1, 1996, as its share of this payment.

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 vary significantly.

j. Cost of Unreimbursed 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."

k. Accounting Change

Effective January 1, 1995, the Financial Accounting Manual was changed to require the Bank to use the accrual method of accounting to recognize the obligation to provide benefits to former or inactive employees, consistent with the requirements of Statement of Financial Accounting Standards ("SFAS") No. 112, "Employers' Accounting for Postemployment Benefits." Prior to 1995, the Bank recognized costs for postemployment benefits when paid. The cumulative effect of this change in accounting for benefits was recognized by the Bank as a one-time charge to expense of $6 million. Additionally, the Bank recognized an increase in 1995 operating expenses of approximately $1 million as a result of the change in accounting for these costs.

Effective January 1, 1995, the Bank also began accruing a liability for employees' rights to receive compensation for future absences consistent with SFAS No. 43, "Accounting for Compensated Absences." Prior to 1995, the Bank recognized these costs when paid. The cumulative effect of this change in accounting for compensated absences was recognized by the Bank as a one-time charge to expense of
Accounting for compensated absences was recognized by the Bank as a one-time charge to expense of $350 thousand. Ongoing operating expenses for the year ended December 31, 1995, were not materially affected by the change in accounting for these costs.


U.S. government and federal agency securities represent the Bank’s designated interest in securities bought outright, which are held in the SOMA at the FRBNY. The Bank’s designated interest is derived from an annual settlement, performed in April of each year, of interdistrict clearings and equalization among the Reserve Banks of gold certificate holdings to Federal Reserve notes outstanding. The Bank’s designated interest in securities bought outright was approximately 8.470% and 7.937% at December 31, 1996 and December 31, 1995, respectively.

U.S. government and federal agency securities are recorded at cost on a settlement-date basis, adjusted for the amortization of premiums and accretion of discounts. Gains and losses resulting from sales of securities are determined for each specific issue based on average cost. Interest income is recorded on the accrual method. Interest income and gains and losses on the sale of these securities are allocated to the Bank based on its designated interest in the total portfolio and are reported as "Interest on U.S. government securities" and "Government securities gains, net", respectively.

Total U.S. government and federal agency securities bought outright, which are held in the SOMA, and the Bank’s designated interest at December 31, 1996 and December 31, 1995, were as follows (in millions):

<table>
<thead>
<tr>
<th>December 31, 1996</th>
<th>December 31, 1995</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total bought outright</td>
<td>Designated to Bank</td>
</tr>
<tr>
<td>Par value:</td>
<td></td>
</tr>
<tr>
<td>Federal agency</td>
<td>$2,225</td>
</tr>
<tr>
<td>U.S. Government:</td>
<td></td>
</tr>
<tr>
<td>Bills</td>
<td>190,646</td>
</tr>
<tr>
<td>Notes</td>
<td>150,922</td>
</tr>
<tr>
<td>Bonds</td>
<td>49,339</td>
</tr>
<tr>
<td>Total par value</td>
<td>393,132</td>
</tr>
<tr>
<td>Unamortized premiums</td>
<td>4,677</td>
</tr>
<tr>
<td>Unaccreted discounts</td>
<td>(3,548)</td>
</tr>
<tr>
<td>Total</td>
<td>$394,261</td>
</tr>
</tbody>
</table>

The maturities of U.S. government and federal agency securities bought outright, which are held in the SOMA, at December 31, 1996, were as follows (in millions):

<table>
<thead>
<tr>
<th>Par value, December 31, 1996</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maturities of Securities Held</td>
</tr>
<tr>
<td>-----------------------------</td>
</tr>
<tr>
<td>Within 15 days</td>
</tr>
<tr>
<td>16 days to 90 days</td>
</tr>
<tr>
<td>91 days to 1 year</td>
</tr>
<tr>
<td>Over 1 year to 5 years</td>
</tr>
<tr>
<td>Over 5 years to 10 yrs</td>
</tr>
<tr>
<td>Over 10 years</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

The maturities of U.S. government and federal agency securities bought outright, which are designated to the Bank, at December 31, 1996, were as follows (in millions):

<table>
<thead>
<tr>
<th>Par value, December 31, 1996</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maturities of Securities Held</td>
</tr>
<tr>
<td>-----------------------------</td>
</tr>
<tr>
<td>Within 15 days</td>
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<td>16 days to 90 days</td>
</tr>
<tr>
<td>91 days to 1 year</td>
</tr>
<tr>
<td>Over 1 year to 5 years</td>
</tr>
<tr>
<td>Over 5 years to 10 yrs</td>
</tr>
<tr>
<td>Over 10 years</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>
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 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 based upon the ratio of its 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 13.656% and 13.906% at December 31, 1996 and December 31, 1995, respectively.

Investments denominated in foreign currencies are recorded at cost on a settlement date basis, adjusted for amortization of premiums and accretion of discounts. Foreign currency-denominated assets of the Reserve Banks are revalued monthly at current market exchange rates in order to report these assets in U.S. dollars. Gains and losses resulting from sales of securities are determined using the average cost method. Interest income is recorded on the accrual basis. Realized and unrealized foreign currency gains and losses and interest income are allocated to the Bank based on its designated interest in the total portfolio and are reported as "Foreign currency gains (losses), net", and "Interest on foreign currencies", respectively.

Total investments denominated in foreign currencies, valued at current exchange rates at December 31, 1996 and December 31, 1995, and the Bank’s designated share, were as follows (in millions):

<table>
<thead>
<tr>
<th></th>
<th>December 31, 1996</th>
<th>December 31, 1995</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total foreign currencies</strong></td>
<td>$19,269</td>
<td>$21,104</td>
</tr>
<tr>
<td><strong>Designated to Bank</strong></td>
<td>$2,631</td>
<td>$84</td>
</tr>
</tbody>
</table>

6. Bank Premises and Equipment:
6. Bank Premises and Equipment:

A summary of bank premises and equipment at December 31, 1996 and December 31, 1995 is as follows (in millions):

<table>
<thead>
<tr>
<th></th>
<th>December 31, 1996</th>
<th>December 31, 1995</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank premises and equipment:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land</td>
<td>$23</td>
<td>$23</td>
</tr>
<tr>
<td>Buildings</td>
<td>145</td>
<td>139</td>
</tr>
<tr>
<td>Building machinery &amp; equipment</td>
<td>35</td>
<td>35</td>
</tr>
<tr>
<td>Construction in progress</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Furniture and equipment</td>
<td>124</td>
<td>115</td>
</tr>
<tr>
<td></td>
<td>329</td>
<td>314</td>
</tr>
<tr>
<td>Less: Accumulated depreciation</td>
<td>109</td>
<td>108</td>
</tr>
<tr>
<td>Bank premises and equipment, net</td>
<td>$220</td>
<td>$206</td>
</tr>
</tbody>
</table>

Depreciation expense was $16 million and $15 million for the years ended December 31, 1996 and December 31, 1995, respectively.

The Bank leases unused space to outside tenants. These leases have terms ranging from 1 to 2 years. Rental income from such leases was $1 million and $2 million for the years ended December 31, 1996 and December 31, 1995, respectively. Future minimum lease payments under agreements in existence at December 31, 1996, are not material.

7. Commitments and Contingencies:

At December 31, 1996, the Bank was obligated under noncancelable leases for premises and equipment with terms of approximately 1 year. 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 $459 thousand and $1 million for the years ended December 31, 1996 and December 31, 1995, respectively. Certain of the Bank's leases have options to renew. Future minimum rental payments under noncancelable operating leases and capital leases, net of sublease rentals, with terms of one year or more, at December 31, 1996, are not material.

There were no other material commitments and long-term obligations in excess of one year at December 31, 1996.

Under the Insurance Agreement of the Federal Reserve Banks dated as of June 7, 1994, 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 of the claiming Reserve Bank, up to 50% of total capital and surplus of all Reserve Banks. No claims were outstanding under such agreement at December 31, 1996 or December 31, 1995.

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 System (the "System Plan") and the Benefit Equalization Retirement Plan (the "BEP"). These plans cover employees of the 12 Reserve Banks, the Board of Governors, and the Plan Administrative Office.

The System Plan is a multi-employer plan. Contributions are actuarially determined and fully funded by participating employers at amounts prescribed by the Plan Administrator (with the exception of a mandatory contribution of 7% of salary by certain employees of the Board of Governors that participate in the plan). No separate accounting is maintained of assets contributed by the participating employers, and net pension cost allocated to the Bank for the period is the Bank's required contribution for the period. No contributions to the System Plan were required during 1996 or 1995.

The BEP is an unfunded plan that was established January 1, 1996. Net pension cost for the period is actuarially determined and is based on the same economic and mortality assumptions used for the System plan. The Bank's projected benefit obligation and net pension costs for the BEP at December 31, 1996 and for the year then ended are not material.

Thrift Plan:

Employees of the Bank may also participate in the Thrift Plan for Employees of the Federal Reserve System (the "Thrift Plan"). The Thrift Plan is a defined contribution plan. Under the Thrift Plan, employees may contribute a percentage of their salaries up to a maximum 19% limit as prescribed by the Internal Revenue Service. Matching contributions by the Bank are based on a fixed percentage of each employee's basic contribution. Currently, the Bank matches 80% of the first 6% of salary contributed by the employee. The Bank's Thrift Plan contributions totaled $5 million and $4 million for the years ended December 31, 1996 and December 31, 1995, respectively, and are reflected on the Statement of Income 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 defined benefit 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 retiree medical plan is contributory and provides benefits to retirees, their covered dependents, and beneficiaries. The life insurance plan is noncontributory and covers retirees only.

The Bank funds benefits payable under the medical and life insurance plans as due. Net postretirement benefit cost is actuarially determined, using a January 1 measurement date. The following is a reconciliation between the plan’s funded status and the amounts recognized in the Bank’s balance sheet as of December 31, 1996 and December 31, 1995 (in millions):

<table>
<thead>
<tr>
<th></th>
<th>December 31, 1996</th>
<th>December 31, 1995</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accumulated postretirement benefit obligation:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retirees and covered spouses</td>
<td>$ 22</td>
<td>$ 22</td>
</tr>
<tr>
<td>Actives eligible to retire</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Other actives and disableds</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Total accumulated postretirement benefit obligation</td>
<td>35</td>
<td>35</td>
</tr>
<tr>
<td>Unrecognized net gain</td>
<td>11</td>
<td>9</td>
</tr>
<tr>
<td>Unrecognized prior service cost</td>
<td>16</td>
<td>17</td>
</tr>
<tr>
<td>Accrued postretirement benefit cost</td>
<td>$ 62</td>
<td>$ 61</td>
</tr>
</tbody>
</table>

The assumptions used in developing the postretirement benefit obligation are as follows:

<table>
<thead>
<tr>
<th></th>
<th>1996</th>
<th>1995</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discount rate</td>
<td>7.25 %</td>
<td>7.00 %</td>
</tr>
<tr>
<td>Rate of increase in health care costs - initial</td>
<td>9.50 %</td>
<td>10.00 %</td>
</tr>
<tr>
<td>Rate of increase in health care costs - ultimate</td>
<td>5.50 %</td>
<td>5.50 %</td>
</tr>
</tbody>
</table>

*The ultimate health care cost rate is expected to be achieved in 2004.*

The following is a summary of the components of net periodic postretirement cost for the years ended December 31, 1996 and December 31, 1995 (in millions).

<table>
<thead>
<tr>
<th></th>
<th>1996</th>
<th>1995</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service cost</td>
<td>$ 1</td>
<td>$ 1</td>
</tr>
<tr>
<td>Interest cost of accumulated benefit obligation</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Net amortization and deferral</td>
<td>(2)</td>
<td>(2)</td>
</tr>
<tr>
<td>Net periodic postretirement cost</td>
<td>$ 1</td>
<td>$ 1</td>
</tr>
</tbody>
</table>

These costs are reflected on the Statement of Income as a component of "Salaries and other benefits."

Changing the assumed health care cost trend rates by one percentage point in each year would change the accumulated postretirement benefit obligation at December 31, 1996 and December 31, 1995, by approximately $4 million and $3 million, respectively, and would change the aggregate service and interest cost components of net periodic postretirement benefit cost for both of the years ended December 31, 1996 and December 31, 1995, by approximately $300 thousand.

Postemployment benefits:

The Bank began using the accrual method of accounting to recognize the obligation to provide benefits to former or inactive employees, consistent with SFAS No. 112 "Employers Accounting for Postemployment Benefits," effective January 1, 1995. Benefits include medical and dental insurance, survivor income and disability benefits. Costs were projected using the same discount rate and the same health care trend rates as were used for projecting postretirement costs. The accrued postemployment benefit costs recognized by the Bank at December 31, 1996 and December 31, 1995, was $8 million and $7 million, respectively. This cost is included as a component of "Accrued benefit cost" on the Statement of Condition. Net periodic postemployment benefit costs included in both 1996 and 1995 operating expenses was $2 million.