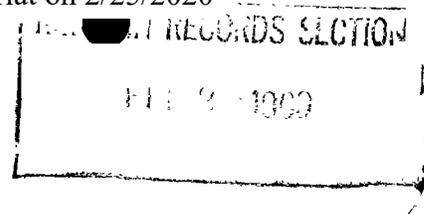




BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON



February 24, 1960

CONFIDENTIAL (FR)

TO: Federal Open Market Committee

FROM: Mr. Young

Enclosed is a memorandum from Messrs. Rouse and Farrell dated February 19, 1960, which makes certain suggestions for change in the procedure followed in making allocations of securities in the System Open Market Account. The proposals contained in this memorandum are being presented to the Federal Open Market Committee for consideration at the meeting on March 1, 1960. (Agenda Item 6.b.)

Also enclosed is a memorandum from Messrs. Rouse and Farrell dated February 23, 1960, which contains a pro forma re-allocation of securities held in the System Account as of February 1, 1960, based on the existing procedure.

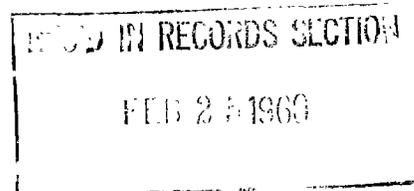
Enclosures

To Federal Open Market Committee

February 19, 1960

From Robert G. Rouse and
John R. Farrell

SUGGESTED CHANGES IN PROCEDURES
IN ALLOCATION OF SECURITIES IN
SYSTEM OPEN MARKET ACCOUNT



The plan of allocation of securities in the System Open Market Account approved by the Federal Open Market Committee at its meeting on June 11, 1953 and reaffirmed at its meeting on August 25, 1953 has proven generally satisfactory. The banks at all times have been able to carry the securities allotted to them without causing their reserve ratios to be reduced below the minimums provided by the plan and consequently up to this time none of the interim adjustments, which had been so troublesome under the previous formula, have been necessary. Two matters related to the allocation procedures, however, are presented herewith for consideration. The first suggests allocation of profits and losses on the basis of current holding ratios, rather than on the average daily participations in total holdings over a five year period; the second calls for clarification of the wording of the statement of procedures to be followed if application of the total asset formula in the annual reallocation should reduce the reserve ratio of any bank below 35 per cent.

Treatment of Profits and Losses

Paragraph 7 of the statement of procedures adopted by the Federal Open Market Committee in 1953 relating to the allocation of profits and losses on the sale of securities for the System Open Market Account provides:

7. Profits and losses on the sale of securities from the Account shall be allocated on the basis of average daily participations in total holdings in the Account during the preceding five years. These ratios shall be computed as of the end of each month for the succeeding month.

The distribution of profits and losses on the basis of average holdings over a period was adopted on the theory that the profit or loss on a sale of

securities reflects the price paid as well as the price received and should be considered in connection with the earnings received during the interval. Distribution of profits and losses on the basis of holdings over a period therefore was looked upon as more equitable than on the basis of participations on the date of sale. Actually the average holding period for securities sold from the Account since adoption of the present plan has been much less than five years. Undoubtedly it was something less than three months because over the past five years all sales from the Account have consisted of Treasury bills, with the exception of \$53.0 million certificates held less than three months and \$82.5 million notes held about seven months which were sold in February 1957 at a time when bill holdings were very low. In view of the relatively short holding period under a policy of dealing mainly in Treasury bills, it is believed that current holding ratios would provide a more logical basis of allocation than the five year ratios, and it is RECOMMENDED that this basis be adopted.

Distribution of profits and losses on the basis of current allocations would result in a material simplification of the accounting work, particularly with respect to the operation of the emergency program. Supplying adequate data to the relocation offices to permit reconstruction of the moving averages has presented a troublesome problem. Each month a photostatic copy of the computations of the average daily holdings of each of the banks is sent to the relocation offices. Once a year aggregates of daily holdings for a full five year period are revised (these figures are huge, running into trillions) in order to keep the work of reconstructing the averages within reasonable bounds. When these revised figures are received, the banks are instructed to destroy all the monthly copies of the computations that they hold. Reconstructing the ratios in an emergency would present a considerable chore. Aggregates for each new month would have to be added and aggregates for the corresponding months deducted

from the base figures. At the month end it would be necessary to compile aggregates for the month in which the emergency occurred by adjusting daily holdings for the transactions of that month.

All banks having been able to hold their full participations, the average holding ratios based on daily aggregate balances for a five year period theoretically should equal the average of the five annual total asset ratios in effect over that period. However, there would actually be small differences due to the effect of rounding to multiples of \$1,000 in the application of the total asset ratios to changes in the Account. Because of year to year variations in the total asset ratios, the five year holding ratios also would be somewhat different from the current total asset ratios, but the difference in dollars to any Reserve bank between allocation of profits and losses on the five year holding ratios or on the current one year total asset ratios would be too small to justify the complex mathematical calculations involved in maintaining the moving averages even if use of those ratios were fully justified in theory.

Annual Reallocation

Paragraph 3, which relates to the procedure to be followed if the application of the total asset formula should reduce the reserve ratio of any bank below 35 per cent in the annual reallocation on April 1, reads as follows:

3. No allocation shall be made which would reduce the reserve ratio of a bank below 35 per cent. If, because of the provisions of this paragraph, a bank is unable to take its prorata share based on total assets, the amount which it is unable to take without reducing its reserve ratio below 35 per cent shall be allocated to the bank or banks having the highest reserve ratios in such a manner that the ratio of the bank or banks to which securities are reallocated will not be reduced below the ratio of any other bank. Regardless of possible subsequent improvement in reserve ratios, no reversal of these adjustments shall take place pending the next general reallocation.

Paragraph 3 does not specify whether the calculation for the reallocation is to be based on the reserve ratios as of the last day, or as of the next to the last day, of March, and we believe that it is important to have this clarified

before the April 1, 1960 reallocation. Up to 1953 the calculations had been based on the reserve ratios as of the next to the last day of the month, but since adoption of the present plan it has been the practice to show in the reallocation computations the reserve ratios as of the last day of March both before and after the reallocation. These reserve ratios are not available until the afternoon of April 1, whereas by then the telegrams to the banks relating to the changes in the Account due to the reallocation have already been dispatched. Therefore, if the March 31 ratios should show a need for an adjustment all accounting work would have to be redone and corrected telegrams dispatched which would result in great confusion in bookkeeping at all Reserve banks. The use of reserve ratios as of the next to the last day of March for reallocation purposes would be consistent with past practice as well as with other provisions of the recent plan. In principle the use of ratios for the next to the last day is just as valid as using those for the last day of March. It is RECOMMENDED, therefore, that the first sentence of paragraph 3 be amended to read as follows: "No allocation shall be made which would reduce the reserve ratio of a bank as of the next to the last business day of March below 35 per cent."

Paragraph 5 of the present plan, which relates to possible Wednesday or month-end adjustments pinpoints the date of the reserve ratio on which a possible interim adjustment might be based as a "Tuesday" or the "next to the last day of the month". That also conforms with previous practice. Interim adjustments, however, are considerably less complicated than a complete reallocation. Ordinarily only a few of the Reserve banks are involved in an adjustment and the telegrams are not dispatched until the afternoon when it is clear whether or not one will be necessary. No change in this paragraph is proposed other than clarification of the wording to provide against the contingency of the close of a statement week falling on some day other than

a Wednesday because of a holiday. It is SUGGESTED that the second line of paragraph 5 reading "on a Tuesday or the next to the last day of the month" be amended to read "on the next to the last business day (as observed by the Agent Bank) of a statement week or month."

Regardless of whether the suggested changes in paragraphs 3 and 5 are adopted, it will continue to be possible, although unlikely, that an individual Bank's reserve ratio might be published at less than 35 per cent on a reallocation date; and it will continue to be possible that an individual Bank's reserve ratio might be published at less than 30 per cent at a month end or be at less than 30 per cent at a Wednesday, when only the System ratio is published by the Board, but the individual ratios are published by some Reserve banks. In such a situation paragraph 6, providing for a voluntary adjustment in participation holdings, could become operative.

February 23, 1960

TO: Federal Open Market Committee
FROM: Robert G. Rouse and John R. Farrell

FILED IN RECORDS SECTION

FEB 24 1960

The procedure for allocation of securities in the Open Market Account which became effective September 1, 1953 (Mr. Riefler's letter of August 25, 1953), provides that:

"Securities in the Account shall be reallocated April 1 of each year on the basis of daily averages of total assets for the 12 months ending with the last day of February."

In anticipation of the meeting of the Federal Open Market Committee on March 1, at which the procedure for allocation of securities will be reviewed, a pro forma reallocation of securities held in the System Open Market Account has been made as of February 1, 1960, based on the ratios of each Bank's average total assets for the 11-month period March 1, 1959-January 31, 1960 (337 days). It is expected that only minor changes in percentage participations will occur during the remaining month of the prescribed base period.

On the pro forma basis, the larger gains in participation percentage points are .36 for Atlanta and .33 for San Francisco; and larger losses are .40 for New York and .18 for Chicago. Other changes are all less than .09 percentage points, as detailed in Table II.

The pro forma reallocation would increase the dollar amount of participations of five Banks and decrease those of seven Banks, as summarized from Table I:

To: Federal Open Market Committee -2-

	<u>Increases in participation</u>		<u>Decreases in participation</u>
Philadelphia	\$5,729,000	Boston	\$11,585,000
Atlanta	68,508,000	New York	79,891,000
Minneapolis	17,265,000	Cleveland	14,667,000
Dallas	9,320,000	Richmond	20,499,000
San Francisco	84,208,000	Chicago	46,573,000
		St. Louis	6,773,000
		Kansas City	5,042,000
	<u>\$185,030,000</u>		<u>\$185,030,000</u>

Under this pro forma reallocation, the shifts in participation to Atlanta and San Francisco and from New York would all be larger in amount than any previous reallocation since this basis was adopted in 1953.

The foregoing figures are net, after a special \$22,524,000 adjustment from Atlanta to New York to prevent Atlanta's reserve ratio falling below 35 per cent, as provided in paragraph 3 of Statement of Procedures with Respect to Allocations of the System Open Market Account. Since the adoption of the current basis for allocation, this is the first time it has been necessary to invoke this paragraph.

It has never been necessary to invoke paragraphs 5 or 6 of the Statement of Procedures, which provide for adjustments of participations in the event a Bank's reserve ratio falls below 30 per cent.

The high and low reserve ratios during the period April 1, 1959- January 31, 1960, and on January 31, 1960, are shown in Table III. The highest ratio reached during this period was San Francisco's 49.1 on April 20; and the lowest was Minneapolis's 32.1 on December 18-20. System ratios ranged between 42.9 and 38.6.

To: Federal Open Market Committee -3-

The largest changes in reserve ratios resulting from the pro forma reallocation would be decreases of 2.6 (net, after the special adjustment) per cent to 35.0 at Atlanta, 1.6 per cent to 37.4 at Minneapolis, and 1.5 per cent to 42.6 at San Francisco; no increases would be greater than .7 per cent. The ratios would range from 43.4 at New York to 35.0 at Atlanta, as shown in Table I. Had Atlanta not been subject to adjustment, its reserve ratio would be 34.1 per cent.

Continuing the 4.3 point decline in the year ended April 1, 1959, the System's reserve ratio has dropped an additional 2.3 points to 40.6 per cent during the period April 1, 1959 through January 31, 1960. The current decline has resulted from the continued outflow of gold and from increased member bank borrowing; System Open Market Account securities holdings are at about the same level.

Table IV shows, by months and in terms of index numbers, the relative growth of each Bank and the System. It is based on average annual total assets used for the previous reallocation. The largest change is in the relative growth in total assets at Atlanta.

On the basis of the 11 months' experience reflected in the pro forma reallocation as of February 1, there appears to be no occasion for not making the forthcoming reallocation under existing procedure. At the time of reallocation an adjustment may be necessary at one or more Banks to prevent reserve ratios from falling below 35 per cent.

Robert G. Rouse

John R. Farrell

Attachments:

Tables I, II, III, and IV.

PRO FORMA REALLOCATION OF U. S. GOVERNMENT SECURITIES IN SYSTEM OPEN MARKET ACCOUNT, FEBRUARY 1, 1960
(In thousands of dollars)

TABLE I

	System	Boston	New York	Phila- delphia	Cleve- land	Richmond	Atlanta	Chicago	St. Louis	Minne- apolis	Kansas City	Dallas	San Francisco
A. Daily average of total assets, March 1, 1959 - January 31, 1960	53,050,693	2,852,031	13,136,922	3,037,232	4,562,455	3,357,193	2,985,627	9,083,508	2,143,452	1,244,333	2,276,227	2,136,898	6,234,815
B. Ratio (per cent) based on "A"	100.0	5.3760	24.7630	5.7251	8.6002	6.3283	5.6279	17.1223	4.0404	2.3455	4.2907	4.0280	11.7526
C. Actual allocations January 31, 1960	25,463,607	1,380,509	6,407,968	1,452,088	2,204,588	1,631,912	1,342,034	4,406,528	1,035,605	579,984	1,097,609	1,016,354	2,908,428
D. Allocation on basis of "B"	25,463,607	1,368,924	6,305,553	1,457,817	2,189,921	1,611,413	1,433,066	4,359,955	1,028,832	597,249	1,092,567	1,025,674	2,992,636
E. Difference	+ 207,554	- 11,585	- 102,415	+ 5,729	- 14,667	- 20,499	+ 91,032	- 46,573	- 6,773	+ 17,265	- 5,042	+ 9,320	+ 84,208
E.1 Distribution of that portion of "D" which Banks cannot take without lowering reserve ratios below 35 per cent	+ 22,524		+ 22,524				- 22,524						
E.2 Net change in participation	+ 185,030	- 11,585	- 79,891	+ 5,729	- 14,667	- 20,499	+ 68,508	- 46,573	- 6,773	+ 17,265	- 5,042	+ 9,320	+ 84,208
F. Actual reserve ratio (per cent) January 31, 1960	40.6	37.9	42.7	40.3	39.8	36.4	37.6	41.1	38.4	39.0	37.8	37.7	44.1
G. Reserve ratio (per cent) January 31, 1960 adjusted for allocation	40.6	38.4	43.4	40.1	40.1	37.1	35.0	41.7	38.7	37.4	38.0	37.2	42.6

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM,
DIVISION OF BANK OPERATIONS.

COMPARISON OF EACH FEDERAL RESERVE BANK'S PER CENT OF PARTICIPATIONS
IN THE SYSTEM OPEN MARKET ACCOUNT

TABLE II

Federal Reserve Bank	Present (4-1-59)	Pro forma (1-31-60)	Potential change	
			Increase	Decrease
Boston	5.4215	5.3760		.0455
New York	25.1652	24.7630		.4022
Philadelphia	5.7026	5.7251	.0225	
Cleveland	8.6578	8.6002		.0576
Richmond	6.4088	6.3283		.0805
Atlanta	5.2704	5.6279	.3575	
Chicago	17.3052	17.1223		.1829
St. Louis	4.0670	4.0404		.0266
Minneapolis	2.2777	2.3455	.0678	
Kansas City	4.3105	4.2907		.0198
Dallas	3.9914	4.0280	.0366	
San Francisco	11.4219	11.7526	.3307	
Totals	100.0	100.0	.8151	.8151

Memorandum

1% of Open Market Account 1-31-60 = \$254,600,000
 .1% " " " " " = 25,460,000
 .01% " " " " " = 2,546,000

BOARD OF GOVERNORS
 OF THE FEDERAL RESERVE SYSTEM,
 DIVISION OF BANK OPERATIONS.

COMPARISON OF RESERVE RATIOS APRIL 1, 1959 - JANUARY 31, 1960

TABLE III

Federal Reserve Bank	Ratios on April 1, 1959	Ratios on January 31, 1960	High ratios		Low ratios	
			Date	Per cent	Date	Per cent
Boston	40.1	37.9	11/16/59	41.3	9/11-13/59	33.6
New York	44.6	42.7	6/10/59	45.3	9/16/59	38.3
Philadelphia	42.9	40.3	4/27/59	44.4	1/15/60	37.5
Cleveland	44.2	39.8	4/20/59	44.8	9/17/59	38.3
Richmond	39.0	36.4	10/9-11/59	43.4	1/4/60	34.8
Atlanta	38.9	37.6	4/10-12/59	41.3	9/8/59	34.0
Chicago	42.8	41.1	5/27/59	43.6	1/4/60	36.1
St. Louis	41.7	38.4	11/12/59	43.6	1/4/60	35.0
Minneapolis	43.7	39.0	4/6/59	45.6	12/18-20/59	32.1
Kansas City	40.4	37.8	4/16/59	42.2	7/9/59	32.7
Dallas	41.3	37.7	4/9/59	43.8	11/30/59	34.4
San Francisco	45.4	44.1	4/20/59	49.1	7/22/59	42.3
System	42.9	40.6	4/1/59	42.9	1/4/60	38.6

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM,
DIVISION OF BANK OPERATIONS.

INDEX NUMBERS--DAILY AVERAGE TOTAL ASSETS OF FEDERAL RESERVE BANKS
 BY MONTHS, JANUARY 1959 - JANUARY 1960
 (Average total assets for year ended February 28, 1959 = 100)

TABLE IV

Federal Reserve Bank	1959												1960
	January	February	March	April	May	June	July	August	September	October	November	December	January
Boston	101.41	99.64	98.98	99.66	99.68	100.54	101.12	100.72	101.75	102.24	103.58	103.02	101.24
New York	100.86	99.26	99.55	99.78	99.91	100.00	100.83	99.68	100.44	100.09	100.74	102.19	100.75
Philadelphia	101.79	100.07	99.86	100.99	101.74	101.72	102.34	102.31	102.71	102.35	104.32	104.96	103.05
Cleveland	101.40	100.16	99.78	100.80	100.90	101.24	102.34	101.58	101.88	100.93	101.24	102.69	101.05
Richmond	101.55	99.71	99.10	98.84	98.34	99.49	99.86	100.20	102.49	103.20	102.37	102.90	101.04
Atlanta	107.33	106.37	105.90	107.00	106.82	106.59	108.37	108.37	109.63	109.04	110.08	113.21	112.92
Chicago	100.97	100.35	99.63	99.75	100.29	100.63	101.07	101.05	101.47	101.32	101.87	102.26	100.70
St. Louis	102.39	100.23	99.74	99.40	99.36	99.83	100.23	99.72	100.90	102.77	104.33	105.39	102.87
Minneapolis	104.20	101.52	102.99	103.69	104.06	104.66	105.64	105.95	106.02	106.41	105.73	105.57	104.59
Kansas City	102.47	101.94	101.14	101.28	100.61	101.10	101.63	101.49	101.42	101.20	101.49	102.85	102.50
Dallas	103.94	103.20	101.82	101.49	101.07	101.20	101.51	101.87	103.80	103.54	104.69	106.01	105.19
San Francisco	103.07	101.55	102.01	103.02	103.49	104.00	104.60	104.97	106.62	105.64	106.41	107.84	105.80
System	101.98	100.65	100.40	100.82	100.97	101.31	102.02	101.69	102.59	102.36	103.03	104.11	102.59

BOARD OF GOVERNORS
 OF THE FEDERAL RESERVE SYSTEM,
 DIVISION OF BANK OPERATIONS.

PRO FORMA REALLOCATION OF U. S. GOVERNMENT SECURITIES
(In thousands of dollars)

	System	Boston	New York	Phila- delphia	Cleve- land	Re-
A. Daily average of total assets, March 1, 1959 - January 31, 1960	53,050,693	2,852,031	13,136,922	3,037,232	4,562,455	3.
B. Ratio (per cent) based on "A"	100.0	5.3760	24.7630	5.7251	8.6002	
C. Actual allocations January 31, 1960	25,463,607	1,380,509	6,407,968	1,452,088	2,204,588	1
D. Allocation on basis of "B"	25,463,607	1,368,924	6,305,553	1,457,817	2,189,921	1
E. Difference	+ - 207,554	- 11,585	- 102,415	+ 5,729	- 14,667	-
E.1 Distribution of that portion of "D" which Banks cannot take without lowering reserve ratios below 35 per cent	+ - 22,524		+ 22,524			
E.2 Net change in participation	+ - 185,030	- 11,585	- 79,891	+ 5,729	- 14,667	
F. Actual reserve ratio (per cent) January 31, 1960	40.6	37.9	42.7	40.3	39.8	
G. Reserve ratio (per cent) January 31, 1960 adjusted for allocation	40.6	38.4	43.4	40.1	40.1	

Authorized for public release by the FOMC Secretariat on 2/25/2020
 COMPARISON OF EACH FEDERAL RESERVE BANK'S PER CENT OF PARTICIPATIONS
 IN THE SYSTEM OPEN MARKET ACCOUNT

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Chicago	17.3052	17.1223		.1829
St. Louis	4.0670	4.0404		.0266
Minneapolis	2.2777	2.3455	.0678	
Kansas City	4.3105	4.2907		.0198
Dallas	3.9914	4.0280	.0366	
San Francisco	11.4219	11.7526	.3307	
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BOARD OF GOVERNORS
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COMPARISON OF RESERVE RATIOS APRIL 1, 1959 - JANUARY 31, 1960

TABLE III

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Cleveland	44.2	39.8	4/20/59	44.8	9/17/59	38.3
Richmond	39.0	36.4	10/9-11/59	43.4	1/4/60	34.8
Atlanta	38.9	37.6	4/10-12/59	41.3	9/8/59	34.0
Chicago	42.8	41.1	5/27/59	43.6	1/4/60	36.1
St. Louis	41.7	38.4	11/12/59	43.6	1/4/60	35.0
Minneapolis	43.7	39.0	4/6/59	45.6	12/18-20/59	32.1
Kansas City	40.4	37.8	4/16/59	42.2	7/9/59	32.7
Dallas	41.3	37.7	4/9/59	43.8	11/30/59	34.4
San Francisco	45.4	44.1	4/20/59	49.1	7/22/59	42.3
System	42.9	40.6	4/1/59	42.9	1/4/60	38.6

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM,
DIVISION OF BANK OPERATIONS.

INDEX NUMBERS--DAILY AVERAGE TOTAL ASSETS OF FEDERAL RESERVE BANKS
 BY MONTHS, JANUARY 1959 - JANUARY 1960
 (Average total assets for year ended February 26, 1959 = 100)

TABLE IV

Federal Reserve Bank	1959												1960
	January	February	March	April	May	June	July	August	September	October	November	December	January
Boston	101.41	99.64	98.98	99.66	99.68	100.54	101.12	100.72	101.75	102.24	103.58	103.02	101.24
New York	100.86	99.26	99.55	99.78	99.91	100.00	100.83	99.68	100.44	100.09	100.74	102.19	100.75
Philadelphia	101.79	100.07	99.86	100.99	101.74	101.72	102.34	102.31	102.71	102.35	104.32	104.96	103.05
Cleveland	101.40	100.16	99.78	100.80	100.90	101.24	102.34	101.58	101.88	100.93	101.24	102.69	101.05
Richmond	101.55	99.71	99.10	98.84	98.34	99.49	99.86	100.20	102.49	103.20	102.37	102.90	101.04
Atlanta	107.33	106.37	105.90	107.00	106.82	106.59	108.37	108.37	109.63	109.04	110.08	113.21	112.92
Chicago	100.97	100.35	99.63	99.75	100.29	100.63	101.07	101.05	101.47	101.32	101.87	102.26	100.70
St. Louis	102.39	100.23	99.74	99.40	99.36	99.83	100.23	99.72	100.90	102.77	104.33	105.39	102.87
Minneapolis	104.20	101.52	102.91	103.69	104.06	104.66	105.64	105.95	106.02	106.41	105.73	105.57	104.59
Kansas City	102.47	101.94	101.14	101.28	100.61	101.10	101.63	101.49	101.42	101.20	101.49	102.85	102.50
Dallas	103.94	103.20	101.82	101.49	101.07	101.20	101.51	101.87	103.80	103.54	104.69	106.01	105.19
San Francisco	103.07	101.55	102.01	103.02	103.49	104.00	104.60	104.97	106.62	105.64	106.41	107.84	105.80
System	101.98	100.65	100.40	100.82	100.97	101.31	102.02	101.69	102.59	102.36	103.03	104.11	102.59

BOARD OF GOVERNORS
 OF THE FEDERAL RESERVE SYSTEM,
 DIVISION OF BANK OPERATIONS.