



Federal Reserve
Bank of Dallas

ANNUAL
REPORT 2017

The Federal Reserve Bank of
Dallas and the Impact of
Hurricane Harvey

Letter from President Robert S. Kaplan

The Eleventh District economy had a strong year in 2017. Texas job growth was 2.1 percent, and the unemployment rate reached 3.9 percent in the fourth quarter, the lowest unemployment rate since the data began being compiled in the 1970s. Texas continues to be a magnet for people and firms, the state's economy continues to diversify, and the energy industry has stabilized and continues to recover from its recent downturn.

Dallas Fed economists expect this strong growth to continue in 2018. In addition, our economists expect solid gross domestic product growth in the U.S. due to a strong consumer as well as improved business investment.

Against this backdrop, our team at the Dallas Fed is focused on improving our economic research and overall thought leadership, particularly in the areas of energy, trade and immigration. We are also striving to be a leading citizen in our communities by actively working on early childhood literacy, college readiness, the digital divide, access to financial services and workforce development. We continue to emphasize our core operations of supervising financial institutions in our district, performing cash services, and working with other Federal Reserve Banks to oversee various types of payment and Treasury services in our district and nation.



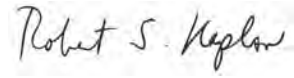
Dallas Fed President Robert S. Kaplan thanks the Houston Branch staff for their dedicated service during Hurricane Harvey.

While advancing our mission, the Dallas Fed and each of our branches, beginning in August of last year, faced a critical challenge along with our fellow Texans: the devastating impact of Hurricane Harvey.

In this annual report, we concentrate primarily on the hurricane and the myriad ways the Federal Reserve Bank of Dallas worked to serve our communities before, during and after this terrible storm. We highlight the work of our Houston Branch and key areas of our Bank, which worked closely with state and local agencies and nonprofit and community leaders to help identify and support those most affected by this natural disaster. I am particularly proud of the performance of all our employees in the Eleventh District in responding to this tremendous challenge.

All of us at the Dallas Fed are honored to serve our district and nation.
We look forward to actively pursuing our mission in 2018 and the years
ahead.

Sincerely,

A handwritten signature in black ink that reads "Robert S. Kaplan". The signature is written in a cursive, flowing style.

Robert S. Kaplan



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Letter from First Vice President Meredith N. Black

The Federal Reserve Bank of Dallas research library houses three volumes of congressional testimony dating from 1913 on the formation of the Federal Reserve System. A key debate of the day was whether to establish the new central bank as a single centralized entity located in Washington, D.C., or as a federated organization in the form of the regional reserve banks that we have today. This debate centered on the historical American fear of vesting too much power in either Washington or Wall Street.

Ultimately, the compromise that resulted in the Federal Reserve we know today also gave the System its greatest strength—12 federated reserve banks working closely with the citizenry and businesses in each region to not only represent their economic interests in Washington, but also meet their needs in times of crisis. We need look no further than the hurricanes that have hit the Texas Gulf Coast, the most recent occurring in August 2017, to see the value of a regional central bank system played out in ways not imagined in 1913.

After Hurricane Harvey made landfall along the Texas Gulf Coast on Aug. 25, it caused widespread damage and broad disruption to the regional economy. The hurricane's Category 4 winds and storm surge devastated the Texas Coastal Bend area, while its record-breaking rains

brought catastrophic flooding throughout the Houston region and eastward to the Beaumont area.

According to the National Hurricane Center, Harvey was the second-costliest hurricane in U.S. history (behind Katrina), the deadliest hurricane to hit Texas since 1919 and the most significant tropical cyclone rainfall event in U.S. history in both scope and quantity of rain.

With much of the Eleventh District in the path of the storm, Dallas Fed employees, especially at our Houston Branch, worked closely with local authorities to meet the needs of people and businesses in affected areas.

As Gulf Coast communities rebuild post-Harvey, we will continue to help residents and businesses address economic challenges, including access to credit, availability of affordable housing and small-business needs. We will also play an ongoing role in measuring and forecasting Harvey's economic impact on the region and state as a whole.

As chief operating officer and a 35-year employee of this Bank, I am proud of the efforts of my fellow employees to serve the citizens, businesses and financial institutions in our district. They do this on a daily basis, willingly, tirelessly and without fanfare. The actions of our employees in response to Hurricane Harvey highlight the value of our regional System beyond the traditional liquidity-backstop function it performs. I hope the five vignettes in this annual report offer a glimpse of the service we are so honored to provide.

Sincerely,

A handwritten signature in black ink, reading "Meredith N. Black". The signature is written in a cursive, flowing style.

Meredith N. Black



Weathering Harvey

by Daron Peschel | Houston Branch

With its proximity to the Gulf Coast, the Houston region knows how to take a punch from a hurricane. But Hurricane Harvey was different—the scale and scope of the storm knocked the city down hard.

For Houston, Harvey was not a storm surge or wind event like a traditional hurricane but a devastating flood event—a 1,000-year flood event, according to some weather experts. Almost every part of the Houston region was impacted. More than 1 trillion gallons of rainwater fell just on Harris County, according to the Harris County Flood Control District. The county is Texas' most populous, with nearly 4.6 million residents.

The flood control district reported that, over four days, most areas of the county received about a year's worth of rainfall—between 40 and 50 inches. Over 70 percent of the county had at least 18 inches of flood water,¹ and an estimated 120,000 of the county's homes and businesses experienced some degree of flood damage.²

To prepare for the storm, the Federal Reserve Bank of Dallas' Houston Branch employees worked closely with local authorities and colleagues across the Eleventh Federal Reserve District. Activities focused on three priorities: ensuring the safety and well-being of employees and their families, protecting the branch facility and its assets, and providing critical services to the Houston region.

In this effort, the branch partnered with organizations that included the Houston Police Department, Harris County Office of Emergency Management and U.S. Secret Service to monitor conditions and coordinate responses.

Fortifications for the flood at the Houston Branch began with the building itself, years before Harvey. The building sits just across the street from Buffalo Bayou, a major watershed in the region.



The Houston Branch before and after Harvey.

The facility was in the design phase during 2001 when flooding from Tropical Storm Allison devastated downtown Houston, and lessons learned were incorporated into the branch's final plan. The overall building elevation stands above the 500-year floodplain at 50 feet above sea level, raising critical operations out of the most vulnerable flood zone.

During Hurricane Harvey, the design safeguards proved effective. Floodwaters from Buffalo Bayou rose up the outer perimeter wall but did not breach it. All facilities inside remained secure.

Throughout the five-day storm, the branch housed 18 employees on-site to provide security, monitor the building infrastructure and respond to emergency conditions around the clock. They included law enforcement,

facilities and management staff. In addition, a cadre of Cash Department employees stayed at a nearby hotel to ensure staff were available to meet the region's financial needs.

On-site staff worked 12 to 16 hours each day and slept in shifts. Several faced the additional challenge of remaining on duty even when their own families were forced to evacuate their homes. One employee recalls, "My wife, kids and two dogs had to leave due to a mandatory evacuation in our area. Like many, I was concerned for my family's safety since they were evacuating during the storm. Bank leadership checked in with me often, and it was comforting knowing that they cared about my situation and not just the building."

With its facility secure and fully operational, the Houston Branch also came to the aid of a neighbor in distress. That Sunday morning, with Buffalo Bayou rising rapidly, local CBS affiliate KHOU-TV contacted the branch to request emergency shelter for its news staff.

KHOU's building down the street was taking on water at an alarming rate. With the station's parking garage flooded as well, 45 KHOU employees evacuated on foot, carrying their equipment and belongings through the driving rain.

Houston Branch staff met the employees with carts and pickup trucks to bring them inside and set them up with work space, electrical hookups, coffee, water and lunch. When KHOU's emergency generators failed and the station lost the ability to broadcast over the air, reporters turned to social media—streaming live from the branch to ensure that storm updates still went out to the Houston community.



Staff from Houston CBS affiliate KHOU-TV take refuge in the Houston Branch building after their station is flooded during Hurricane Harvey.

In the months since Harvey, the Houston Branch has continued to support the region's recovery, even as many of its staff members have been working to recover at home. One in five branch employees experienced some level of storm damage, with one in 10 suffering major property losses.

With generous support from colleagues throughout the Eleventh District and the Federal Reserve System, the branch has worked with employees affected by the storm to provide financial assistance and other resources. Staff have also volunteered their time to assist with community recovery efforts from a deluge that left no portion of the Houston region untouched.

NOTES

1. Harris County Flood Control District meteorologist Jeff Lindner, Aug. 31, 2017, twitter.com/JeffLindner1/status/903412604902760448.
2. Harris County Flood Control District, www.hcfcd.org/hurricane-harvey/.



Supplying Cash

by Rick Mase and Michelle Treviño | Cash Services

As Hurricane Harvey churned off the Texas coast, the cash team in the Dallas Fed's Houston Branch prepared for the storm's impact. In the week prior to landfall, essential staff reserved hotel rooms two blocks from the branch to ensure they would be on-site to communicate with financial institutions and support currency needs throughout the region.

Financial institutions' demand for cash rose sharply as the region's residents prepared for the storm's onslaught and aftermath. Leading up to the storm, banks along the Gulf Coast ordered \$453 million worth of currency from the Houston Branch, and banks in South Texas ordered \$243 million—a combined 43 percent increase compared with the same week in 2016.

Quick and thorough communication was crucial to meet the demand for currency. Multiple conference calls took place daily among the Eleventh District's cash management team, Federal Reserve System cash officials, financial institutions and armored carriers.

The hurricane made landfall on Friday, Aug. 25, and the city of Houston began to experience the effects of the storm by Saturday night. The rain continued full force through Sunday.

As the rain increased more rapidly than forecasters expected, cash orders from Central and South Texas banks that were normally handled

by the Houston Branch were rerouted to the Dallas office for processing.

On Monday, the first business day after Harvey struck, the Houston cash team prepared all of its cash orders for banks in the immediate Gulf Coast area. However, widespread flooding prevented armored carriers from making it to the branch on both Monday and Tuesday.



On Wednesday, as the heaviest rain shifted to the east of Houston and floodwaters began to subside, an armored carrier successfully picked up several cash orders for banks. Houston cash employees who were not significantly impacted by the flooding also began returning to work. By Thursday, even the armored carriers servicing the Beaumont area, 85 miles up the coast, were able to operate despite the rain and flooding.

In the months following the storm, a new issue emerged: Banks in the Gulf Coast region began depositing unusually large quantities of currency soaked by floodwaters.

Federal Reserve Banks are charged with ensuring the integrity of the nation's currency by removing unfit bills from circulation. Accordingly, the Houston cash team spent countless hours handling these deposits

following a scripted process to fully account for the value of the deposit and keep themselves from being exposed to potential hazards from the currency. About \$20.4 million in contaminated currency was destroyed and replaced with bills fit for circulation to the public.



Monitoring Banks

by Vince Pacheco | Banking Supervision

As Hurricane Harvey approached, the Dallas Fed began to focus on how financial institutions would respond to the storm and how the public's access to banking services would be impacted. Soon after the hurricane's initial impact, the Federal Reserve partnered with other federal and state regulatory authorities, as well as industry representatives, on a daily basis to monitor the operating status of financial institutions.

During the first few days after landfall, it became clear the storm damage was severe—and in some cases devastating—to many communities. Where the damage was so severe that it rendered banks' facilities temporarily unusable, regulatory agencies suspended prior approval branching requirements and communicated to banks that they could share facilities to continue serving their customers.

In the storm's aftermath, bankers worked diligently to resume operations, with much success. By the end of the first week, more than 95 percent of all affected commercial bank branches reopened to the public. However, some challenges remained.

The ability of banks to provide cash to their customers was a concern. Flooded roadways hampered armored carriers' access to the Federal Reserve's Houston Branch to pick up cash for delivery to their client banks.

Compounding the challenge, drivers for the armored carriers were focused on their own safety and that of their families, and some were not immediately available. The Dallas Fed issued daily communications to provide clarity on Federal Reserve cash services. Fortunately, banks were prepared and resourceful and were able to meet the needs of their customers.

As banks began to resume operations and plan long-term recovery efforts, bankers turned their attention to customers, many of whom were facing significant financial challenges.

The Federal Reserve, along with other regulatory agencies, encouraged bankers to work with affected customers and emphasized that consideration would be given to changes in banks' financial condition resulting from the hurricane. In addition, the agencies extended flexibility to banks for filing financial reports and rescheduling bank examinations to minimize burden during the cleanup efforts.

While many will feel the effects of Harvey long into the future, financial institutions in the affected areas demonstrated strong resiliency and remain healthy. Good communication among the Federal Reserve, banks, other regulatory agencies and trade associations was key during the crisis and will continue to play an important role in the rebuilding process.



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Serving the Community

by Kevin Dancy | Community Development

Hurricane Harvey affected communities across all socioeconomic backgrounds, but the storm severely devastated many low- and moderate-income communities and further exposed challenges those individuals and families already face. Immediately following Harvey's landfall, many banks, community development financial institutions (CDFIs), credit unions and nonprofits mobilized to help the region recover.

To help banks understand the Community Reinvestment Act's (CRA) application to disaster recovery efforts, the Dallas Fed led an interagency effort with the Office of the Comptroller of the Currency and Federal Deposit Insurance Corp. to host a series of CRA bankers' roundtables across the affected region. These roundtables brought together individuals representing federal agencies, banks, nonprofits and community leaders from areas impacted by the storm. They came from Houston, Victoria, Rockport, Corpus Christi, Beaumont and places in between to explore opportunities, collaborations and investments available through the CRA.

One of the most devastating impacts of Harvey was damage caused to homes and housing structures, placing greater strain on a housing system already stretched thin. In Harris County, prior to the storm, more than 30 percent of households were classified as "housing-cost burdened." This is where residents spend more than 30 percent of their

annual income on housing costs, including utilities. It is anticipated that this number will continue to grow as many families living in or near poverty seek to find replacement housing in a market that was already under intense pressure for housing options prior to the hurricane.



Houston Branch employee Gisele Crouchet helps residents clean their flooded homes.

Rural communities across the impacted region face similar affordable-housing challenges. In Wharton, Texas—a city of roughly 8,800 residents with a median household income of approximately \$33,000 (more than \$20,000 less than the state median household income level)—nearly half of the city’s total housing stock was affected by Hurricane Harvey.

Following the storm, the Dallas Fed worked with nonprofits, philanthropic organizations and banks to identify potential solutions for housing repair, reconstruction and replacement needs within rural and urban communities along the Texas coast. Working in collaboration with numerous housing organizations, the Dallas Fed will remain a resource on housing strategy for years to come as it focuses on long-term recovery and resiliency for the residents of Southeast Texas.

Small businesses were among the hardest hit by Hurricane Harvey and have experienced significant challenges as they work to recover and reopen. Six months following Harvey, about 70 percent of the small businesses in the Gulf Coast city of Rockport are still closed, and uncertainty remains regarding how many will rebuild.¹ Many small-business owners did not seek assistance or apply for available small-business loans, citing a fear of increased debt, misinformation about Small Business Administration (SBA) disaster loan products and a lack of adequate insurance coverage as primary reasons.

Working with banks and interagency partners, including the SBA and the Federal Home Loan Bank of Dallas, the Dallas Fed launched an awareness campaign to highlight grant and lending resources that financial institutions may make available to small businesses within their assessment areas. The Bank also worked with numerous local chambers of commerce to identify small businesses in need and connect them to financial institutions and CDFIs with available disaster-recovery resources.

As the region begins its long-term recovery, the Dallas Fed will continue to address the needs of low- and moderate-income individuals and communities across the Eleventh District. Greater interagency collaboration is vital, and the Dallas Fed will continue to provide leadership and play a significant role as a convener of people, organizations and businesses.

Key themes that have surfaced as a result of the Dallas Fed's in-depth public engagement in the months following Hurricane Harvey include resident displacement fears, flood insurance availability, flood mitigation and equitable recovery.

The Dallas Fed's report, "[Seizing the Opportunity for Equitable and Inclusive Redevelopment](#)," highlights lessons from 2008's Hurricane Ike

that could provide helpful insight for communities rebuilding from Harvey.

NOTE

1. See “Rockport Hurricane Harvey Update,” Travel Texas Media Room, available at: travel.texas.gov/media-press/hurricane-harvey-updates/rockport/.



Measuring the Impact

by Keith Phillips | Economic Research

Hurricane Harvey had a devastating impact on hundreds of thousands of individuals along the Texas coast, damaging at least 280,000 homes. The devastation was particularly acute just north of Corpus Christi in towns such as Rockport, Port Aransas and Victoria, where hurricane winds exceeding 100 miles per hour destroyed a large percentage of homes and businesses. In the Houston area, many impacted businesses had the resources to start repairs soon after the water receded. For many homeowners, however, the recovery process continues and may take years.

When measuring the economic impact of a severe weather event, there are two primary types of losses: 1) direct losses that include damage to buildings, structures, vehicles, crops and livestock, and 2) indirect losses that are more temporary and include lost activity such as production, retail sales, wages and tax revenues. By their nature, indirect losses are more difficult to measure and thus their estimates tend to vary greatly.

The impact to local residents' wealth and the pace of the recovery process also differ depending on whether the losses are insured. If the damage is mostly caused by flooding versus wind, generally there will be a greater proportion of uninsured losses since flood insurance is less common than wind insurance.

The most recent direct damage estimate from Harvey estimated by Moody's Analytics is between \$60 billion and \$70 billion. Ranking hurricanes on inflation-adjusted losses, Harvey ranks second nationally behind Hurricane Katrina and ahead of Sandy, according to the National Oceanic and Atmospheric Administration.

Since most of the damage from Harvey was due to flooding, it is estimated that less than a third was covered by insurance.

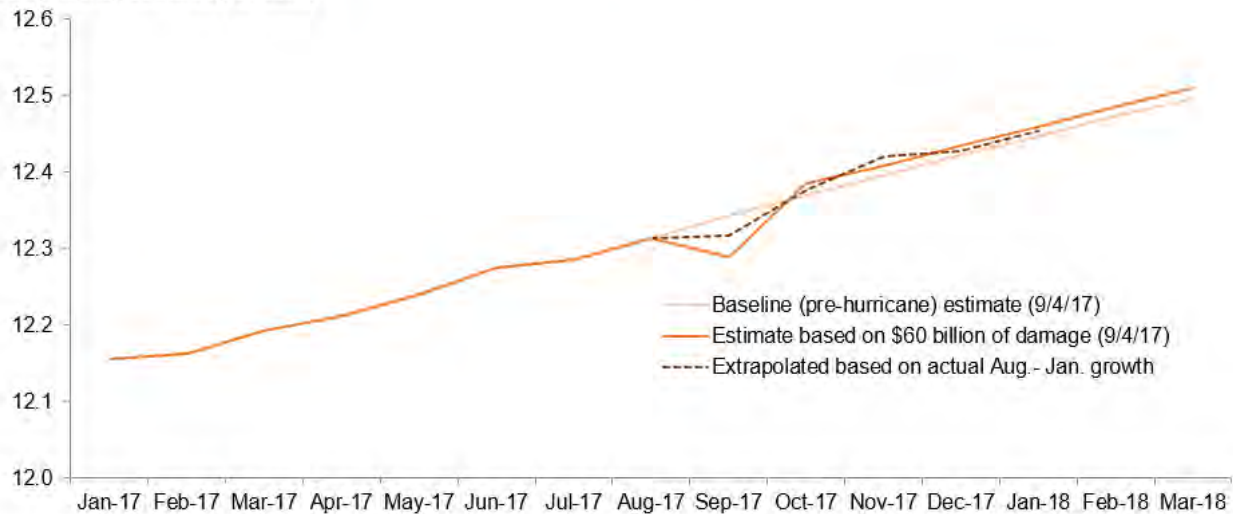
The balance will need to be covered by private savings and public funding. As of mid-December, Texas had received about \$11 billion in federal disaster aid. While the state government, the Small Business Administration, the Red Cross and other charities have also raised money, the total is likely to fall well short of the uninsured losses.

While residents struggle to repair damage to their homes, it is important to know if jobs will continue to grow in the region. Shortly after Harvey occurred, there were requests to ascertain the impact of Harvey on future job growth in the Gulf Coast and Texas. The Dallas Fed took two approaches to estimate the impact.

The first method was to model the path of job growth going forward using estimated losses from past weather events along the coast. The model, estimated in early September based on initial loss estimates, predicted that Texas jobs would decline between 2.3 percent and 5.8 percent in September (versus expected growth with no hurricane of 2.9 percent)—but bounce back in October, growing between 9.9 percent and 15.0 percent and landing slightly above the previous number of jobs expected for October prior to the hurricane. As shown in Chart 1, the actual path of job growth has been similar to what was estimated by the model, although the decline and bounce back have been more subdued – likely due to Harvey having a much larger impact on residential versus business structures than past weather events.

Chart 1
Forecast of Hurricane Harvey Impact Captured Transitory Effect on Texas Jobs

Jobs (millions), seasonally adjusted



SOURCES: Bureau of Labor Statistics; National Oceanic and Atmospheric Administration; authors' calculations.

The second approach was to survey the Bank's numerous business contacts. Special questions on the hurricane impacts were added to the Texas Business Outlook Surveys during September. The [results](#) were consistent with the model in that they showed significant impacts on employment and output that were mostly short lived. The survey results showed that 73 percent of Gulf Coast businesses experienced a shutdown of five days or less, although 64 percent said they had a reduction in revenue for more than five days. Only 16 percent of Gulf Coast respondents reported that the hurricane would result in a significant decrease in revenue or production over a six-month period.

Overall, Hurricane Harvey resulted in a historically large loss of residential and business property on the Texas Gulf Coast that will be felt for years to come. Fortunately, however, Harvey was not able to reverse the positive economic growth trend occurring in the region. Going forward, this region is likely to continue to prosper. However, the number of severe weather events has increased over the past decade, and local leaders will have to address the infrastructure and planning needs to deal with these challenges (see "[On the Record with Harris County Judge Ed Emmett](#)").



Examinations of the Reserve Bank

2017 Financials

The Reserve Banks and the consolidated limited liability company (LLC) entity are subject to several levels of audit and review.

The combined financial statements of the Reserve Banks as well as the annual financial statements of each of the 12 Banks and the consolidated LLC entity are audited annually by an independent auditing firm retained by the Board of Governors. In addition, the Reserve Banks, including the consolidated LLC entity, are subject to oversight by the Board of Governors, which performs its own reviews. The Reserve Banks use the Internal Control—Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) to assess their internal controls over financial reporting, including the safeguarding of assets. Within this framework, the management of each Reserve Bank annually provides an assertion letter to its board of directors that confirms adherence to COSO standards.

The Federal Reserve Board engaged KPMG to audit the 2017 combined and individual financial statements of the Reserve Banks.¹

In 2017, KPMG also conducted audits of internal controls over financial reporting for each of the Reserve Banks. Fees for KPMG services totaled \$6,823,083. To ensure auditor independence, the Board of Governors requires that KPMG be independent in all matters relating to the audits. Specifically, KPMG may not perform services for the Reserve Banks or

others that would place it in a position of auditing its own work, making management decisions on behalf of the Reserve Banks, or in any other way impairing its audit independence. In 2017, the Bank did not engage KPMG for any non-audit services.

[VIEW FINANCIALS](#)

NOTE

1. In addition, KPMG audited the Office of Employee Benefits of the Federal Reserve System (OEB), the Retirement Plan for Employees of the Federal Reserve System (System Plan), and the Thrift Plan for Employees of the Federal Reserve System (Thrift Plan). The System Plan and the Thrift Plan provide retirement benefits to employees of the Board, the Federal Reserve Banks, the OEB, and the Consumer Financial Protection Bureau.



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As of December 31, 2017

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As of December 31, 2017

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As of December 31, 2017

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Joseph S. Tracy
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Senior Economic
Policy Advisor

Heidi M. Mitchell
Privacy Officer

Anthony Murphy
Economic Policy
Advisor and Senior
Economist

Marcus A. Propps
Operations Officer

**Katherine M.
Sedgwick**
Financial
Management
Officer

Edward C. Skelton
Macrosurveillance
Officer

Timothy J. Stearns
Examining Officer

El Paso

**Roberto A.
Coronado**
Vice President in
Charge

Javier R. Jimenez
Assistant Vice
President

Houston

Daron D. Peschel
Senior Vice
President in Charge

Donald N. Bowers II
Vice President

Jason K. Ritchie
Assistant Vice
President

Michelle D. Treviño
Assistant Vice
President

Paul R. Wheeler
Assistant Vice
President

San Antonio

Blake Hastings
Senior Vice
President

Tara F. Payne
Assistant Vice
President

Keith R. Phillips
Assistant Vice
President

Lawrence B. Schiff
Assistant Vice
President