



To Depository Institutions in the Ninth Federal Reserve District:

I am pleased to transmit to you the Federal Reserve Bank of Minneapolis' first Annual Report for Priced Services. In a meaningful way, this report is symbolic of one of the major changes and challenges this Bank experienced in 1981. Indeed, infrequently have the products and services of a public instrumentality been priced and offered in the marketplace in direct competition with similar services offered by private firms. The results have been encouraging to me in a number of important respects.

First, I take some considerable pride in the manner in which my associates and colleagues in the Bank have begun the transition initiated by the Monetary Control Act. I take equal satisfaction from the cooperation we have received from depository institutions—large and small—throughout the Ninth District. Even though there were some missteps on our part, when I look at the magnitude of this initial task and the manner in which it was completed, I can't help but conclude that we are now well positioned to assist in the further evolution of the payments mechanism in the District.

Second, and more importantly, I have come to realize more fully that the Federal Reserve Bank of Minneapolis does indeed have an important role to play in contributing to the efficiency and the effectiveness of the payments mechanism in the District. To some extent that role is simply a direct extension of the fact that we have been in the business for a long time. But, there is more to it than that. I have, for example, been struck by the frequency with which bankers and others tell me how much they value Fed services and Fed prices as a standard for the marketplace. Similarly, it is also clear that the Fed is viewed by bankers and others as something of a "trusted intermediary." Finally, there is also, it seems to me, a recognition of the fact that we can and should play a role as a catalyst for constructive change and innovation. All of these things, of course, bode well for achieving the fundamental intent of the MCA—greater efficiency, integrity, and cost effectiveness in the delivery of payment services.

In the light of all of this, we look to our future in the priced service business with confidence and enthusiasm. The building blocks are now in place, but the greatest challenges lay ahead. We must now become more responsive, more flexible, and more effective in anticipating and meeting the needs of our customers. Quality, efficiency, and responsiveness will be our guideposts. In that spirit, we look forward to better serving the depository institutions and the financial community of the Ninth Federal Reserve District.



A handwritten signature in black ink, reading "E. Gerald Corrigan". The signature is written in a cursive, flowing style.

E. Gerald Corrigan, President
Federal Reserve Bank of Minneapolis

Our People . . .

Introducing Customer Services

Shifting from a framework of providing services only to member banks at no explicit charge to offering services to all depository institutions at an explicit price offered a new challenge to us in 1981. And, if we are to achieve the efficiencies intended by the framers of the Monetary Control Act, it is essential that every depository institution, large or small, have the best information possible in order to select its best alternative for obtaining needed services.

Accordingly, in 1981, we formed a Customer Services Department—with a staff responsible for ensuring that depository institutions have a good understanding of the nature of Fed services, their prices and how to use them effectively.

In Customer Services, we pay attention to the needs of all Ninth District customers, from the largest to the smallest. Our District is large and diverse and includes financial institutions that differ greatly We have to be aware of those differences in order to be sure that the services we provide do, in fact, meet the individual institution's needs.



Stan Medina

Pricing is new to us, but we have been a major supplier of payment services for a long time We have a system firmly established to provide needed financial services



Bob Brandt

We recognize that the Federal Reserve has a lot to offer because it is a national system with national communication and transportation networks, but at the same time, we feel it is important to emphasize the characteristics that distinguish the needs of institutions in the Ninth Federal Reserve District from others in the country.



Ray "Buzz" Hulett

Ours may have been a no-frills approach in the past, but that is not our intent for the future. We have special strengths and considerable expertise in our traditional service lines. . .we plan to build on those strengths and find better ways to serve the needs of our customers.

We are concerned . . . very concerned . . . about our customers' needs.

*Directors of the
Federal Reserve Bank
of Minneapolis*

William G. Phillips
Chairman and
Federal Reserve Agent
John B. Davis, Jr.
Deputy Chairman

*Class A
Elected by Member Banks*

Henry N. Ness (1982)
Senior Vice President
Fargo National Bank
and Trust Company
Fargo, North Dakota
Vern A. Marquardt (1983)
President
Commercial National Bank
L'Anse, Michigan
Dale W. Fern (1984)
President and Chairman
First National Bank
Baldwin, Wisconsin

*Class B
Elected by Member Banks*

Joe F. Kirby (1982)
Chairman
Western Surety Company
Sioux Falls, South Dakota
Harold F. Zigmund (1983)
President
Blandin Paper Company
Grand Rapids, Minnesota
William L. Mathers (1984)
President
Mathers Land Company
Miles City, Montana

*Class C
Appointed by Board of Governors*

Sister Generose Gervais (1982)
Administrator
Saint Mary's Hospital
Rochester, Minnesota
John B. Davis, Jr. (1983)
President
Macalester College
St. Paul, Minnesota
William G. Phillips (1984)
Chairman
International Multifoods
Minneapolis, Minnesota

Term Expires December 31
of Indicated Year

*Directors of the
Helena Branch*

Ernest B. Corrick
Chairman
Gene J. Etchart
Vice Chairman

*Appointed by Board of Directors
Federal Reserve Bank
of Minneapolis*

Harry W. Newlon (1982)
President
First National Bank
Bozeman, Montana
Jase O. Norsworthy (1982)
President
The N-R-G Company
Billings, Montana
Roger H. Ulrich (1983)
President
First State Bank
Malta, Montana

Appointed by Board of Governors

Ernest B. Corrick (1982)
Vice President and General Manager
Champion International Corporation
Timberlands-Rocky Mountain Operations
Milltown, Montana
Gene J. Etchart (1983)
Past President
Hinsdale Livestock Company
Glasgow, Montana

*Member of
Federal Advisory
Council*

Clarence G. Frame
Vice Chairman
First Bank System, Inc.
Minneapolis, Minnesota



Fern, Zigmund, Mathers



Sister Generose Gervais, Phillips, Marquardt



Newlon, Kirby, Davis, Ness

*Officers of the
Federal Reserve Bank
of Minneapolis*

February 1, 1982

E. Gerald Corrigan
President

Thomas E. Gainor
First Vice President

Melvin L. Burstein
Senior Vice President
and General Counsel

Leonard W. Fernelius
Senior Vice President

Gary H. Stern
Senior Vice President
and Director of Research

Sheldon L. Azine
Vice President
and Deputy General Counsel

Lester G. Gable
Vice President

Phil C. Gerber
Vice President

Bruce J. Hedblom
Vice President

Douglas R. Hellweg
Vice President

Ronald E. Kaatz
Vice President

Howard L. Knous
Vice President
and General Auditor

David R. McDonald
Vice President

Clarence W. Nelson
Vice President
and Economic Adviser

Arthur J. Rolnick
Vice President
and Deputy Director of Research

Colleen K. Strand
Vice President

James R. Taylor
Vice President

Robert W. Worcester
Vice President

Robert C. Brandt
Assistant Vice President

James U. Brooks
Assistant Vice President

Marilyn L. Brown
Assistant Vice President

Evelyn F. Carroll
Assistant Vice President

Richard K. Einan
Assistant Vice President
and Assistant Secretary

Caryl W. Hayward
Assistant Vice President

Richard C. Heiber
Assistant Vice President

William B. Holm
Assistant Vice President

Ronald O. Hostad
Assistant Vice President

Ray L. Hulett
Assistant Vice President

Roderick A. Long
Assistant Vice President

James M. Lyon
Secretary and Assistant Counsel

Gerald J. Mallen
Assistant Vice President

Susan J. Manchester
Assistant Vice President

Preston J. Miller
Assistant Vice President

Ruth A. Reister
Assistant Vice President

Charles L. Shromoff
Assistant General Auditor

Kenneth C. Theisen
Assistant Vice President

Theodore E. Umhoefer, Jr.
Assistant Vice President

Joseph R. Vogel
Chief Examiner

Norma J. Wuertz
Assistant Vice President

William G. Wurster
Assistant Vice President



Gainor, Corrigan



Fernelius, Stern, Burstein

*Officers of the
Helena Branch*

Betty J. Lindstrom
Vice President

G. Randall Fraser
Assistant Vice President

Robert F. McNellis
Assistant Vice President

Our Services . . .

The Federal Reserve Bank of Minneapolis continued to achieve higher levels of productivity and efficiency in 1981. And we also introduced a number of changes to our services, illustrating our desire and ability to respond to the challenges of a competitive environment. Some highlights follow:



Check Processing Services



The head office of the Minneapolis Federal Reserve Bank is the second largest check processing operation in the Federal Reserve System—clearing approximately three million checks or check-like instruments each day.

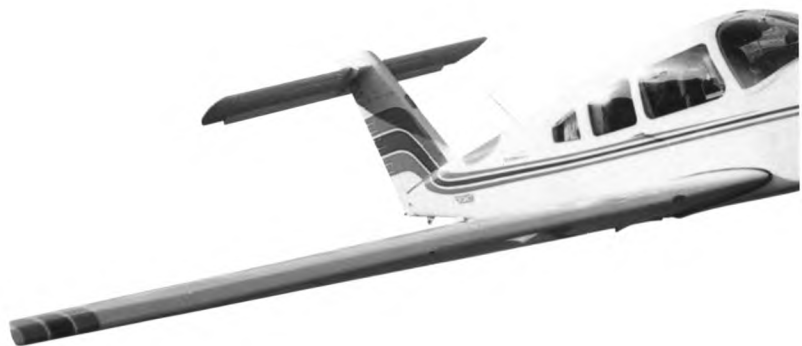
Over the past several years, we have made a sizable investment in upgrading every phase of that operation. New high-speed equipment has been installed which processes more than 90,000 items per hour per machine and significantly reduces the number of

missorted items. While that installation entailed some of the inevitable disruptions that occur during any conversion, the payback associated with the investment in terms of higher efficiency and quality are now being realized. Productivity has increased sharply, float has been reduced to a frictional level, and the number of outstanding adjustment cases has been reduced from more than 8,500 at the beginning of 1981 to only 1,300 by year end.

Check Processing Services

But, more importantly, we now have a foundation in place that will permit us to diversify and tailor our check services to better meet the needs of our customers as well as contribute to a more viable and efficient payments mechanism in the Upper Midwest. Consistent with that objective, in 1981 we:

- Engaged an outside consultant to conduct market research and analysis regarding the needs and priorities of our customers and to recommend changes and enhancements to our service lines.
- Entered into an agreement with the Twin City Clearinghouse to offer a "settlement" service whereby this Bank will provide transportation and net settlement services for fine sort packages drawn on banks in the Twin Cities clearing territory which are not members of the clearinghouse and do not use a member of the clearinghouse for their demand deposit accounting.
- Initiated the Montana Expedited Check Clearing Arrangement (MECCA) to provide overnight check clearing services to a large number of Montana institutions. Through the use of a dedicated air charter service, MECCA checks deposited with Helena at midnight are in the hands of the paying bank later in the morning.
- Began offering a "calculated availability" option at our Helena office. This option enables depositors with a daily average volume of 15,000 items or less to deposit unsorted cash letters on which the Helena Branch calculates credit availability based on the items contained in the cash letter.
- Continued to support the direct exchange of items through local clearing arrangements.



MECCA uses Capital Arrow, Inc., an air charter service in Helena, Montana.

Our accomplishments in 1981 are but a beginning toward meeting our goals of quality, efficiency, and responsiveness. In 1982, further improvements to our check processing services are already underway at our Minneapolis office.

Dollar amount encoding has been added to our array of check clearing services for those financial institutions that, because of volume, cannot justify acquisition of their own encoding equipment. And we also plan to offer a "calculated availability" option for in-zone and out-of-zone items, to raise the daily average volume limit for unsorted items and to provide additional transportation lines to other Federal Reserve offices to improve credit availability.



Automated Clearinghouse

Developments in computer and communications technology over the last few years have enabled the Federal Reserve System to augment its conventional check clearinghouse with an electronic means for exchanging paperless debit and credit entries between financial institutions for customer accounts—the Automated Clearinghouse (ACH).

Through ACH, a financial institution can originate and receive certain

payments automatically and efficiently, thereby reducing the number of checks that otherwise would be written and processed. Currently, both credit and debit payments such as government payments, commercial payrolls, mortgage payments, insurance premiums, and utility bills can be processed through the ACH.

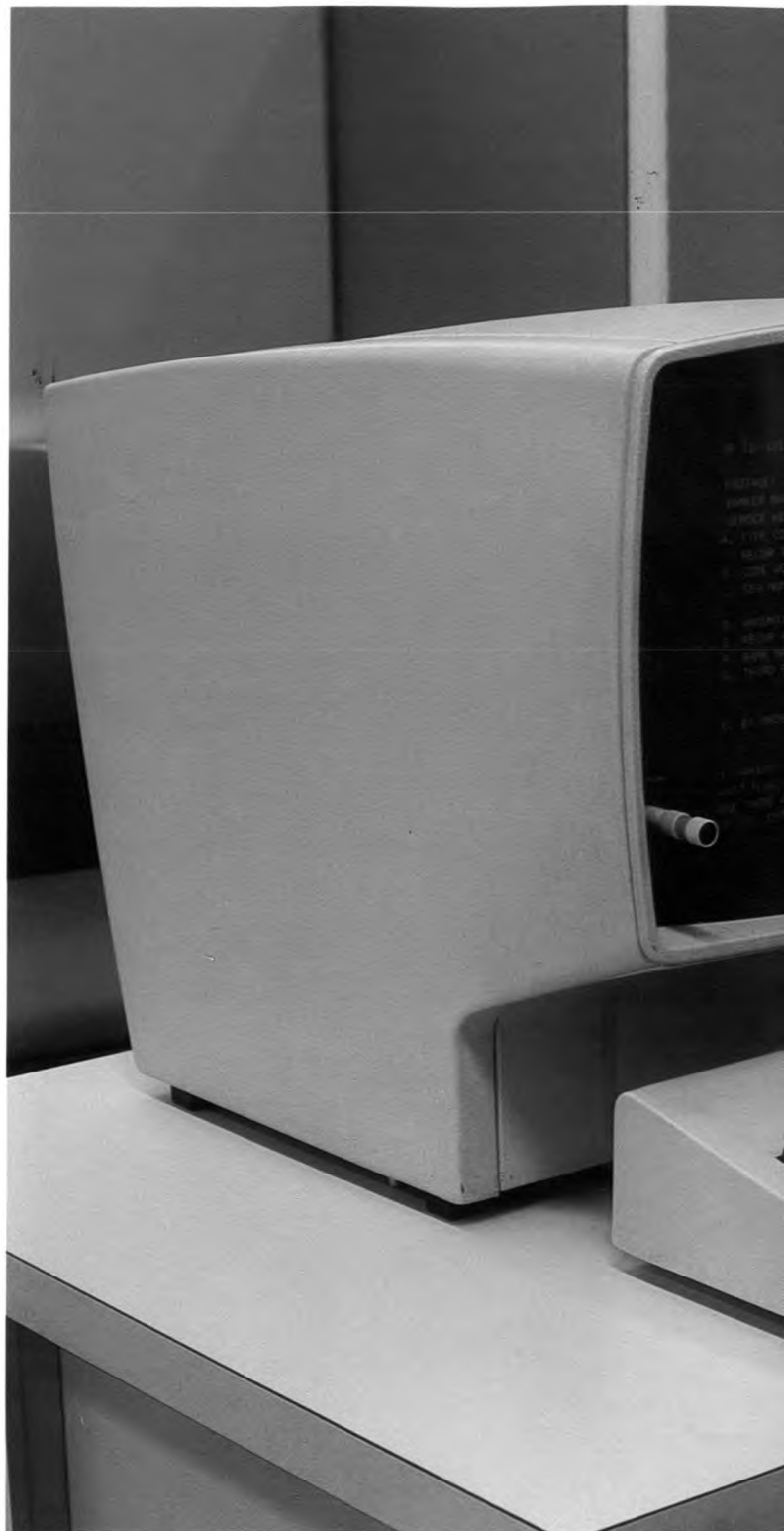
Since its inception, improvements in the system have continued to be developed. For example,

in 1981 we began combined processing of government and commercial files in order to improve the efficiency of ACH operations, particularly in the area of delivery to receivers.

In 1982 we will begin to transmit ACH data via tape to tape data links. This service enhancement will be more efficient and reliable, and will offer remote financial institutions the same delivery deadlines as our local customers.



Funds Transfer Service—
FEDWIRE





FEDWIRE, the Federal Reserve's nationwide telecommunications network, is a unique feature of the Fed's service package. It is the only such facility that permits the irrevocable same day transfer of funds. Through this service, the receiving institution has absolute assurance that the funds received are final payment in "same day" funds.

This has proved to be an invaluable service for depository institutions in effectively managing their

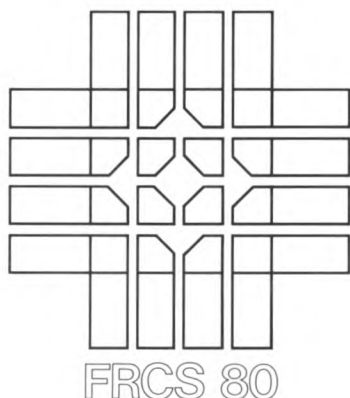
cash and reserve account positions. In addition, financial institutions can make transfers through FEDWIRE on behalf of their customers—again in immediately available funds.

Although transfers can be made either "on-line" or "off-line," the immediate effect of pricing this service in January 1981 was to increase the demand for on-line transfer services nationwide. This increased demand for on-line transfers is due in part to the

Funds Transfer Service—FEDWIRE

difference in pricing—on-line transactions are less expensive because they eliminate the manual processing required in off-line telephone communications.

To update its nationwide communication capacity, the Federal Reserve System is replacing its current communications network with FRCS-80—a new communications system that will provide additional flexibility, security, and capacity. FRCS-80 has been designed with the flexibility to accommodate multiple connections with a variety of terminals and other communications systems. It also provides enhanced speed and efficiency through its packet switching technology. And it will eventually allow another Federal Reserve Bank to receive and process communications for this Bank if our computers are inoperative. The network is expandable to meet volume increases created by additional connections to financial institutions through low-cost, dial-up alternatives to more costly sophisticated computer-to-computer links. This Bank's portion of the FRCS-80 system will become operational in mid-1982.



Recognizing the advantage to our customers of the improved productivity and cost effectiveness of this advanced technology, we began in 1981 to investigate a dial-terminal network to provide low-cost, on-line capabilities. The dial terminal (called FED Link 1) is being offered to institutions through a lease arrangement or through direct purchase and will allow institutions that have a fairly low volume of funds transfers to justify the cost of operating on-line. FED Link 1 will not only permit sending and receiving on-line funds and securities transfers, but will also provide the capability for the following services:



- net settlement
- notification of large dollar return items
- money market and deposit interest rate ceilings
- advice of ACH cash concentration items
- reserve account balances and related information
- advice of cash letter credits
- financial institution name and ABA number changes
- "flash" reports of important financial and economic information

We anticipate offering more services as we explore new ways to better meet customer needs. In this regard, we plan in 1982 to form a "user group" of

depository institutions who can help us determine which service offerings would be most beneficial to depository institutions.

Although FED Link 1 will initially be limited to the first 150 subscribers, we plan to expand the network to as many as 500 institutions by the end of 1983.



Cash Services





*T*he Federal Reserve's services relating to the provision of an "elastic" supply of currency and coin to the public through the network of depository institutions represent a mix of activities. Currency and coin processing operations, for example, are public goods. Thus, activities such as the issuance of new currency and coin, the sorting of fit and unfit currency, and the destruction of unfit notes are essential central bank functions and are not priced.

Cash Services



Only the cost of transporting coin and currency to depository institutions is subject to pricing. This is the only phase of our currency operations where competition in the marketplace can produce the efficiencies and economies contemplated by the drafters of the Monetary Control Act.

Pricing of our cash transportation services began in January 1982. Initially, the price is based on a volume charge and a per stop charge associated with the cost of shipping currency and coin by armored courier from the Fed to individual depository institutions. Where institutions wish to receive currency by registered mail, the fee includes registered mail postage

and insurance costs. Although it is too soon to judge the effects of pricing of our cash transportation services, early results suggest that a number of non-member banks and thrift institutions have decided to participate in our transportation arrangements.

During 1982, we will closely examine our methods of cash transportation and related services. We plan to rearrange some of the armored courier routes to provide better service. And we will explore the possibility of establishing currency depots to serve institutions in the outlying areas of the Ninth District more economically.





With regard to our processing operations, we have entered into a program which, over time, is designed to upgrade the quality of currency in circulation. It should also complement efforts of some institutions to make more widespread use of automated teller machines (ATMs).

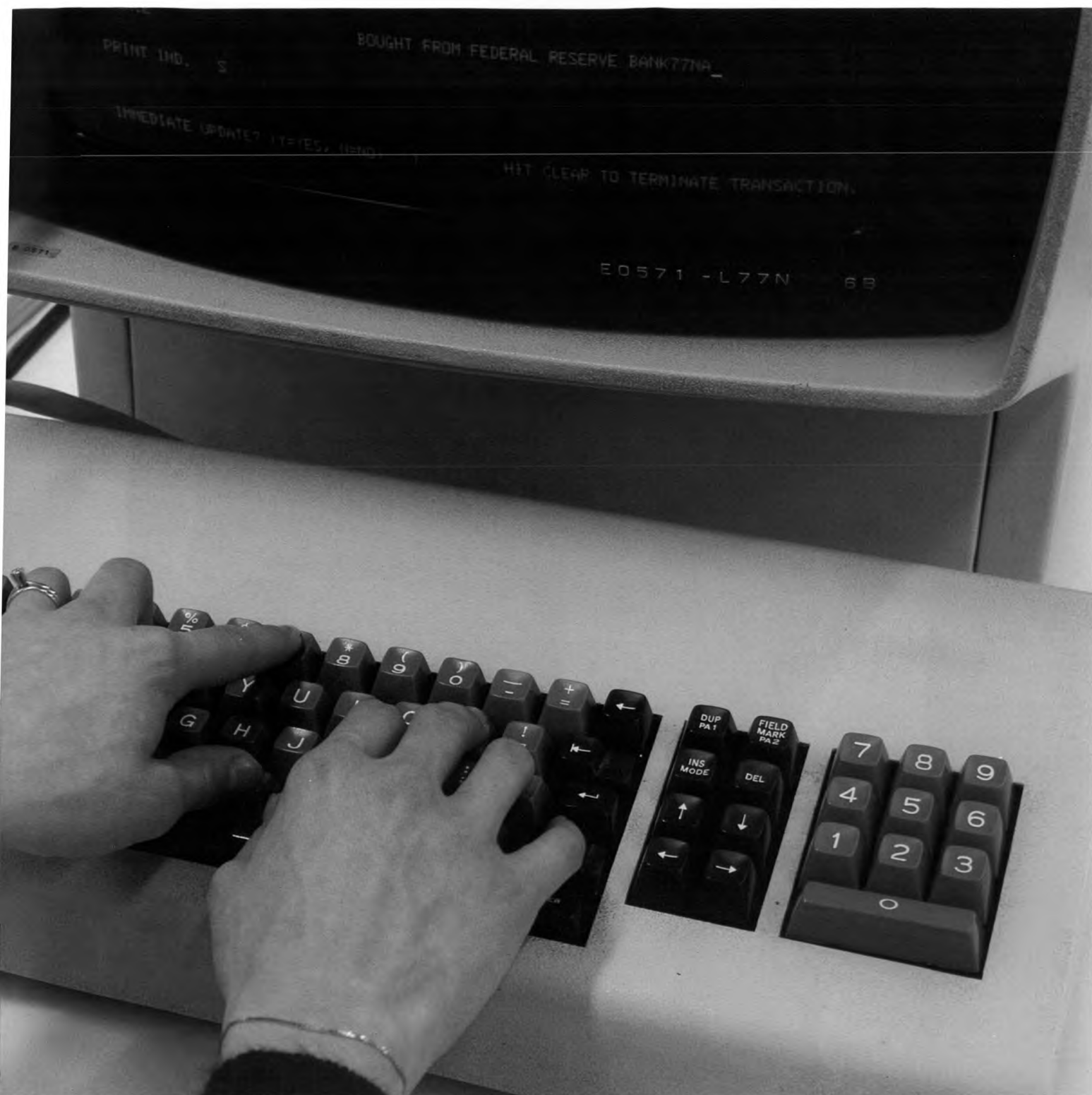
As part of this program, we have installed two high-speed automated currency-processing systems known as CVCS (currency verification, counting, and sorting system). These systems perform all of the basic currency-processing functions formerly done manually—including counting, sorting and verifying note denominations, detecting counterfeits, and destroying unfit notes or packaging fit notes for further circulation. Currently, about 98 percent of our currency is processed on these high-speed machines.

This new technology has had several benefits. It provides a higher and more dependable level of quality control regarding the condition of currency which is put back into circulation by the Fed. In addition, it has significantly reduced processing time which has allowed us to reduce staff and realize substantial cost savings. And it has improved counterfeit detection and reduced costly, labor-intensive currency verification and destruction procedures.



Securities Services





One of the major securities services we offer is the maintenance of accounts and the electronic transfer of securities held by depository institutions in book-entry form—an example where innovation and leadership by the Federal Reserve System has resulted in major efficiencies in the payments system.

Not surprisingly, pricing has had little or no effect on the volume of operations in this area of our securities function. Moreover, steps we have taken in 1981 and

others planned for 1982 should make this highly valuable service more attractive and more accessible to depository institutions in the District. For example, with the expansion of our direct on-line communications network in 1981, 92 percent of all securities transfers are now on-line. The adoption of FED Link 1 in 1982 and the introduction of the FRCS-80 module planned for 1982 will further increase the efficiency, security, and flexibility of our book-entry processing.

Securities Services

Historically, this Bank's definitive securities operations were limited to providing safekeeping services for government and agency security holdings of member banks. Pricing of these services has resulted in a substantial decline in the volume of such securities held in our vaults. To some extent, this decline can be attributed to higher costs related to our philosophy of control and security as the nation's Central Bank. Nevertheless, the volume of such securities held in our vaults remains substantial, and we are looking at ways to make these services more attractive.

For example, around midyear, we anticipate reducing the number of days required to pass credit to our depositors for coupons. In addition, we plan to offer the holding of municipal and corporate securities, certificates of deposit, and corporate stock for customers of financial institutions. We have also identified several other changes to our safekeeping and noncash collection services that we will be pursuing in 1982.



AL OPINION

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UNITED STATES OF AMERICA

STATE OF
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MINNESOTA
STATE BUILDING BOND

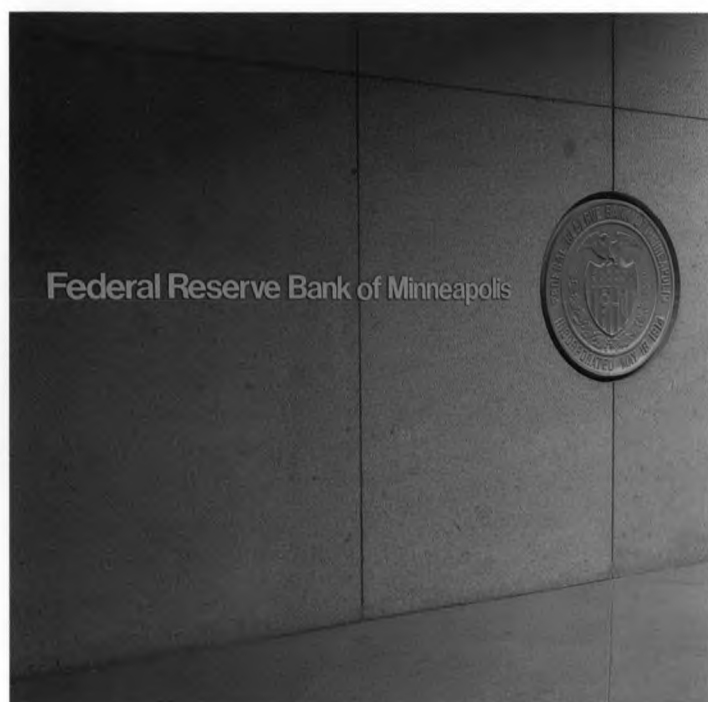
INTEREST PAYABLE
MARCH 1 AND SEPTEMBER 1

PRINCIPAL DUE
SEPTEMBER 1, 1989

Our Challenge . . .

The transition to pricing required us to make some basic changes in the way we operate. Our entire management process and structure were examined and modified to position us to operate in this new environment. We acquired new expertise to market our services and design products to meet the needs of customers in a competitive environment. Pricing also necessitated changes to our operating climate and organizational culture. Extensive resources were required to modify and install new accounting, billing, and related operating systems. Those "mechanical" aspects of the implementation of pricing of our services have been completed in a timely and effective manner.

In 1982, we must move forward and confront more effectively the fundamental challenges created by the pricing environment. In doing that, we must be sensitive to our overall posture. Obviously, we cannot approach the issue of competitive posture in precisely the same manner that a private corporation would. We have public and statutory responsibilities relating to the payments and banking systems that transcend our role as a competitor in the market. And these public responsibilities may, in certain instances, come into conflict with competing in the market, or at least competing in the more traditional ways that private



institutions might compete. Our overriding concern must be to ensure that payment services are provided in the most efficient manner and that the confidence in the payments mechanism is preserved. Therefore, the bottom line is clear. We must not only outline our strategic plans with enough flexibility to be responsive to our customers' needs, but we must act in a fashion that is consistent with the goal of promoting efficiency in the market.

To further complicate matters, we must meet these objectives within the framework of statutory language that imposes constraints on us that would be quite foreign to a private corporation. Obviously, during any initial start-up period such as this, new operational requirements and shifts in volumes and usage patterns will temporarily affect unit costs. But once we have moved through that initial adjustment period, we must diligently chart a course of action that will ensure that our goal of matching revenues and costs is met. The challenge is not simply a matter of changing prices to bring them in line with our costs. To the contrary, we must develop a strategy of pricing—including price changes—that is compatible with our product development and enhancement programs and is also consistent with our cost containment efforts. In turn, the latter requires that we vigorously

and systematically examine each aspect of our resource base. We must make sure that all parts of the productivity equation have been scrutinized. And we must balance short-term productivity gains with investments that will help us realize our long-term goals.

We need to continue to minimize costs, while searching for new service enhancements to improve revenues. And we must ensure that we are realizing all of the cost efficiencies of electronic technology. That technology must be designed to accommodate future growth without proportional increases in operations personnel.

So, the challenge is clear: we must take a hard look at our services to ensure that they do, in fact, meet the needs of all institutions in the District. We must continue to examine our costs, and we must work toward efficiencies in the overall market.

But we are excited and confident about our new role. The challenges that this Bank has met in the past year reflect the maturity and dedication of our staff. We appreciate their past accomplishments and look to them for future achievements. We also appreciate the support of our customers as we continue to search for ways to better fulfill our role in the financial community.

